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ECONOMIC REFORMS IN THE U.S.S.R.

HEARINGS

BEFORE THE

SUBCOMMITTEE ON
NATIONAL SECURITY ECONOMICS

OF THE

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

ONE HUNDREDTH CONGRESS

FIRST SESSION

SEPTEMBER 10, 11, AND 14, AND OCTOBER 5, 1987

Printed for the use of the Joint Economic Committee

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ECONOMIC REFORMS IN THE U.S.S.R.

THURSDAY, SEPTEMBER 10, 1987

Congress of the United States,
Subcommittee on National Security Economics
of the Joint Economic Committee,
Washington, DC.

The subcommittee met, pursuant to notice, at 9:30 a.m., in room SD-538, Dirksen Senate Office Building, Hon. William Proxmire (chairman of the subcommittee) presiding.

Present: Senator Proxmire; and Representatives Scheuer, Wylie, Fish, and McMillan.

Also present: Richard F Kaufman, general counsel.

OPENING STATEMENT OF SENATOR PROXMIRE, CHAIRMAN

Senator **Proxmire**. The Subcommittee on National Security Economics today begins an in-depth examination of the economic initiatives and reforms of General Secretary Mikhail Gorbachev.

Until recently, Gorbachev was widely thought to have been proposing ways to improve the Soviet economic system and perhaps to make some relatively minor modifications. Since June of 1987, the plenary meeting of the Central Committee, the perception of what is taking place in the Soviet Union has changed.

Gorbachev made a number of new proposals at the June meeting which appear to many observers to lay the groundwork for significant if not radical reform of the Soviet economic system.

The changes taking place are the subject of these hearings. A number of important questions must be addressed:

What is the significance of the economic reforms?

Is the Soviet Union moving in the direction of market socialism?

What are the likely consequences for the Soviet economy, assuming the reforms are implemented?

What are the likely consequences for the United States and the West?

How will the reforms influence Soviet defense spending and policy?

Finally, what are the risks and opportunities for the United States and the West?

Before we call our first witness, in order to conserve time, Representatives Wylie, Fish, and McMillan have requested that their written opening statements be inserted in the hearing record; without objection, so ordered.

[The opening statements referred to follow:]

OPENING STATEMENT BY REP. CHALMERS P. WYLIE
BEFORE THE JOINT ECONOMIC COMMITTEE
SUBCOMMITTEE ON NATIONAL SECURITY ECONOMICS
"GORBACHEV'S ECONOMIC REFORMS"
SEPTEMBER 10, 1987

MAY I WELCOME TODAY'S DISTINGUISHED WITNESSES WHO ARE TESTIFYING ON MIKHAIL GORBACHEV'S EFFORTS TO REFORM THE SOVIET ECONOMY. THIS IS A VITAL QUESTION AS YOU HAVE SAID NOT ONLY FOR THE SOVIET UNION, BUT FOR THE UNITED STATES AND ITS ALLIES. I HAVE HAD THE OPPORTUNITY TO MEET WITH SOVIET OFFICIALS OVER THE YEARS, AND THE ISSUE OF ECONOMIC PERFORMANCE IN THAT COUNTRY IS AN INTERESTING STUDY. UNDER JEC AUSPICES, I ALSO HAD THE OPPORTUNITY TO HOLD A HEARING ON U.S.-SOVIET PROSPECTS IN OCTOBER 1985, A MONTH BEFORE THE FIRST REAGAN-GORBACHEV SUMMIT. TWO YEARS IS A LONG TIME IN SOVIET-U.S. RELATIONS, PARTICULARLY IN VIEW OF MIKHAIL GORBACHEV'S SHORT TENURE. NEVERTHELESS, WE HAVE REACHED THE POINT WHERE WE MAY BE ABLE TO MAKE SOME INFORMED JUDGEMENTS ABOUT MR. GORBACHEV'S PROSPECTS WITH RESPECT TO A NUMBER OF VITAL POLICIES -- THE MOST VITAL OF WHICH IS THE FUTURE OF THE SOVIET ECONOMY, AND WHAT THAT FUTURE MEANS FOR THE UNITED STATES.

I WOULD LIKE TO RAISE A COUPLE OF QUESTIONS WHICH SEEM TO ME TO CONSTITUTE THE HEART OF U.S. INTERESTS IN GORBACHEV'S PRESENT REFORM EFFORT:

1. WHAT ARE THE MAIN TENDENCIES ASSOCIATED WITH SOVIET ECONOMIC REFORM THINKING TODAY? FOR EXAMPLE, ARE WE TALKING ABOUT SERIOUS EFFORTS NOW BEING UNDERTAKEN BY GORBACHEV AND HIS NEW CIRCLE OF ADVISERS TO EXPAND THE ROLE OF THE PRIVATE SECTOR, AND TO DECENTRALIZE DECISIONMAKING? OR, ALTERNATIVELY, IS MR. GORBACHEV THINKING ABOUT LESS AMBITIOUS UNDERTAKINGS -- SUCH AS GREATER AUTONOMY FOR FACTORY MANAGERS WITHIN AN OVERALL CONTEXT OF CENTRALIZED DECISIONMAKING?
2. DO WE HAVE A RELIABLE ESTIMATE OF THE ECONOMIC AND POLITICAL COSTS ASSOCIATED WITH GORBACHEV'S REFORM MEASURES? REPORTS COMING OUT OF THE SOVIET UNION, FOR EXAMPLE, STRONGLY SUGGEST THAT UNEMPLOYMENT COULD SIGNIFICANTLY RISE IN THE EVENT GORBACHEV AND HIS MANAGERS SUCCEED IN CLOSING DOWN HUNDREDS -- IF NOT THOUSANDS -- OF POORLY RUN SOVIET ENTERPRISES? IN VIEW OF THE USSR'S PREVIOUS COMMITMENT TO A SO-CALLED "FULL EMPLOYMENT" POLICY, WHAT MIGHT BE THE ECONOMIC AND POLITICAL IMPACT OF SUCH A DRAMATIC POLICY SHIFT? NOT TO MENTION THE SPECIFIC POLITICAL EFFECTS SURROUNDING THESE CHANGES. CAN GORBACHEV SURVIVE A TRULY SUCCESSFUL REFORMIST EFFORT? SOME OF OUR WITNESSES HAVE AS OF LATE GONE ON RECORD SERIOUSLY CHALLENGING HIS ABILITY TO PREVAIL UNDER SUCH CIRCUMSTANCES. ON WHAT BASIS ARE WE MAKING SUCH ESTIMATES; AND WHAT WOULD BE THE CONSEQUENCES, FOR THE SOVIETS AND THE UNITED

STATES, IN THE EVENT GORBACHEV (LIKE KHRUSCHEV BEFORE HIM) IS FORCED FROM POWER BY HIS MORE-RECALCITRANT, BUT WELL ENTRENCHED COLLEAGUES?

I COULD GO FURTHER. BUT IT SEEMS TO ME THESE ARE THE FUNDAMENTAL CONCERNS WHICH BRING US TOGETHER TODAY. SO ON THAT NOTE, I LOOK FORWARD WITH PLEASURE TO YOUR TESTIMONY. THANK YOU.

OPENING STATEMENT BY REP. HAMILTON FISH, JR.
BEFORE THE JOINT ECONOMIC COMMITTEE
SUBCOMMITTEE ON NATIONAL SECURITY ECONOMICS
"GORBACHEV'S ECONOMIC REFORMS"

SEPTEMBER 10, 1987

THE SOVIET UNION IS MAKING HEADLINES EVERY DAY WITH CHANGES, AND MUCH OF THE NEWS IS ENCOURAGING. THE HUMAN RIGHTS LEADER ANDREI SAKHAROV HAS BEEN FREED FROM EXILE IN GORKY, AND A NUMBER OF SOVIET INTELLECTUALS HAVE BEEN FREED FROM PRISON. SOME JEWISH DISSIDENTS -- THOUGH FAR FROM ALL OF THEM -- HAVE BEEN FREED AND ALLOWED TO EMIGRATE. UNDER A POLICY OF "GLASNOST," OR OPENNESS, LITERARY AND ARTISTIC WORKS THAT HAD BEEN BANNED FOR YEARS HAVE BEEN ALLOWED TO APPEAR. JUST DAYS AGO, A DELEGATION OF CONGRESSMEN WAS ALLOWED TO INSPECT AND PHOTOGRAPH A SECRET RADAR SITE AT KRASNOYARSK. THE SOVIET UNION AND THE UNITED STATES APPEAR CLOSE TO AN ARMS CONTROL AGREEMENT THAT, FOR THE FIRST TIME IN HISTORY, WOULD ELIMINATE AN ENTIRE CLASS OF NUCLEAR MISSILES.

THE SOVIET LEADER, MIKHAIL GORBACHEV, HAS PROMISED RADICAL CHANGES, OR "RESTRUCTURING," OF THE ECONOMY AS WELL. A JUNE MEETING OF THE FULL CENTRAL COMMITTEE OF THE COMMUNIST PARTY TOOK UP POTENTIALLY FAR-REACHING ECONOMIC REFORMS INVOLVING PRICING, DECENTRALIZATION AND SO ON.

AS A PARTICIPANT OF THE ASPEN INSTITUTE'S U.S.-SOVIET RELATIONS PROJECT, I HAVE BEEN PRIVILEGED TO PARTICIPATE AS A STUDENT OF THE CHANGES -- AND THE PROMISE OF CHANGE -- IN THE SOVIET UNION. THUS, I AM PARTICULARLY PLEASED THAT THE JEC, WHICH HAS REGULARLY ANALYZED THE SOVIET ECONOMY, IS HEARING FROM EXPERTS FOR THE NEXT THREE WORKING DAYS ON GORBACHEV'S PLANS FOR ECONOMIC REFORM.

I AM CONFIDENT THAT THESE HEARINGS WILL GIVE US A BETTER UNDERSTANDING OF SUCH KEY QUESTIONS AS THESE: WHAT ECONOMIC CHANGES HAS THE SOVIET UNION COMMITTED ITSELF TO AND WHAT CHANGES HAS IT SO FAR SHIED AWAY FROM? INDEED, WHY ARE ECONOMIC CHANGES NECESSARY? WHAT ARE THE DEMANDS OF TODAY'S HIGH-TECH AGE, AND HOW DO THEY CONTRAST WITH THE ECONOMIC SYSTEM THAT STALIN BUILT? HOW ARE ECONOMIC CHANGES INTERTWINED WITH POLITICAL CHANGES? CAN THE SOVIET UNION MODERNIZE ECONOMICALLY WITHOUT RELEASING ITS TOTALITARIAN GRIP ON SOCIETY AS WELL? WHAT ARE THE CHANCES OF SUCCESS? WHAT, IF ANYTHING, CAN THE UNITED STATES DO TO HELP -- AND WHAT, IF ANYTHING, SHOULD IT DO.

THANK YOU.

OPENING STATEMENT BY REP. J. ALEX McMILLAN
BEFORE THE JOINT ECONOMIC COMMITTEE
SUBCOMMITTEE ON NATIONAL SECURITY ECONOMICS
"GORBACHEV'S ECONOMIC REFORMS"
SEPTEMBER 10, 1987

The United States confronts a formidable adversary in the Soviet Union. The question before us today is whether the nature of our adversary is changing--and if it is, what does this portend for future US-Soviet relations? Over the next three days, we will be searching for answers to this question with regard to one significant area, the Soviet economy.

Since becoming General Secretary of the Communist Party of the Soviet Union in March 1985, Mikhail Gorbachev has provided abundant evidence that he intends to significantly alter Soviet behavior patterns; notably in the economy where the USSR's weak performance has prompted Gorbachev and his new team of advisers to speak about a "pre-crisis" condition confronting the USSR. The challenge facing the new Soviet leader (and presumably his successor) is whether he will be able--or willing--to jettison the system of controls which have up to now been used to guide the development of the USSR's economy? The tenor of Gorbachev's public statements over the past two years suggests that he is increasingly concerned about this issue--and within important limits is prepared to seriously challenge traditions and individuals who stand in the way of a more efficient, quality oriented, technologically-based economy.

These domestic Soviet considerations, of course, could have significant long run implications for US-Soviet relations. Speculation is rife--both within and outside of the Soviet Union. On the one hand, Gorbachev and his Soviet allies, along with a number of Western analysts, suggest that major shifts in Soviet economic priorities (a dramatic shift away from military to civilian production, for instance) could result in equally dramatic shifts in Soviet strategic behavior. Gorbachev, for one, provocatively suggests that more flexible Soviet approaches to the management of the domestic economy must be followed by a more accommodating Soviet posture toward the resolution of global trouble spots, including Afghanistan. On the other hand, there are equally compelling reasons to believe that even if Mr. Gorbachev's reformist effort succeeds--a big "if"--it will have little, if any, effect on Soviet external behavior which has a momentum and logic all its own. Seventy years of Soviet expansionism leads me to accept this latter position. The next three days of hearings will allow us to explore this vital consideration.

I look forward to discussing these questions and others with this mornings' distinguished witnesses. Thank you.

Senator **Proxmire**. Today's session will start off with a statement about the national security implications of Soviet economic reforms, prepared by David Wigg, Deputy Assistant Secretary of Defense for Policy Analysis.

Mr. Wigg, I want to thank you especially for your testimony. I think it is excellent. You don't waffle. You come right to the point. You make a judgment about the role that we have played in inducing this that I think is subject to some challenge and I want to get into that with you. But I think in general it is a very positive, excellent, helpful exposition of a situation that is critically important for this country and for the Congress and for our policies. Go right ahead, sir.

STATEMENT OF DAVID G. WIGG, DEPUTY ASSISTANT SECRETARY OF DEFENSE FOR POLICY ANALYSIS, DEPARTMENT OF DEFENSE

Mr. **Wigg**. Thank you, Mr. Chairman. The Department of Defense appreciates the opportunity to get on the record on this important subject. I want to thank Mr. Kaufman for his help, in helping to shape the focus of our effort today. He came over and was very helpful to us.

Senator **Proxmire**. Mr. Wigg, I am going to interrupt to say that I am going to have to leave in about 20 minutes to go to the floor, but we will have a very distinguished member of the committee who will preside in my absence, I hope. I will be gone, I hope, only about 15 or 20 minutes. I have to make a statement on the floor and then I will come right back.

Mr. **Wigg**. All right. I thought I would ask that my prepared statement be accepted into the record in its entirety, but that I would just simply summarize that briefly.

Senator **Proxmire**. That would be very helpful. We have the statement. We had it 24 hours in advance and so you go right ahead.

SOVIET THREAT

Mr. **Wigg**. Let me just gloss over some of the central points.

First of all, I think to give us a little perspective, since the war the defense establishment has, in terms of its mission to preserve and protect U.S. national security, focused primarily on one principal adversary which is the Soviet Union. The Soviets have evolved remarkably since the war from really a regional military power into a nuclear superpower.

I think the point is that the goals of the Soviets and the policies flowing from those goals directly threaten the security and global interests of the United States and its allies and friends.

Most of the hundreds of billions of defense dollars spent annually by NATO and friendly Western governments is geared to defend against the threat to our collective well-being from the Soviets and their client states and allies.

SOVIET ECONOMY

As with all countries, the growth of Soviet power and influence has been based on the development of the Soviet economy. For the past 70 years, the Soviet military industrial complex has come first and the consumer last in Moscow's determination to build the world's most powerful military force as the principal tool of its foreign policy.

Moscow has built a formidable military machine. We feel that the costs of that effort have been extraordinarily high, however, particularly the opportunity costs: vast quantities of inefficiently used resources, a severely distorted economy, a third-rate civilian manufacturing sector—third rate in the sense of their international competitiveness—the inability to consistently feed its people, and poor health standards.

WESTERN TECHNOLOGY

From the beginning, however, Lenin and early Soviet leaders recognized the value of commercial and financial relationships with select Western capitalists. Evolving out of their initial efforts at contact, we now have what we feel is the largest, most systematic, and certainly the most successful program in history to skim the technological cream from an advanced economy to strengthen militarily a less-developed adversary.

For decades, successive Soviet leaders have perpetuated the ideologically driven, military focused, economic and investment policies that I have referred to, which have left the Soviet leadership constantly struggling to absorb Western technological change fast enough to keep Moscow from falling too far behind the West's rapidly advancing development.

ECONOMIC CRISIS

By the 1970's, stresses on the system began to tell. This resulted, for one thing, in the large share of defense in the GNP becoming even larger as the economy began to slow down. By the 1980's the Soviet leadership faced a very serious economic crisis that we believe, unless resolved, could lead to the eventual decline of Soviet power.

The problem essentially was that without greater sophistication and strategy and an improved ability to compete with the free world, Soviet leaders may have realized they were not likely to improve upon the military and geopolitical gains of the 1970's.

Essentially, they had two problems: First of all, how to continue and accelerate flows of technology, funding, and long-term cooperation from the industrial West to give the planned reforms muscle and staying power; second, they wanted to maintain their ambitious military programs and their quite successful yet intense global political-military and active measures campaigns against the United States and its allies.

COMMUNIST LDC'S

By the early 1980's, it was not only the Soviet economy that had run into trouble. The Communist LDC's were in even worse shape and had become a significant drain on resources that were needed in the U.S.S.R. itself. The Soviet mode of economic development had become essentially discredited in the eyes of the developing world.

GORBACHEV'S REFORMS

General Secretary Gorbachev was determined to head off a clash between the competing Soviet needs of economic development on the one hand and force modernization and global engagement on the other. He is attempting to do this by implementing in phases policies designed to raise investment in productivity in Soviet industry and, to a lesser extent, Soviet agriculture.

The scope of the reforms has aroused considerable commentary in the West. While ambitious in intent, we believe they fall far short of the Chinese reforms or the Soviet new economic policy of the 1920's. They do, however, represent a modification of the central planning model and state autarky that has characterized Soviet economic development since the time of Stalin.

MODERNIZATION

It is our judgment that the Soviet military will not be disadvantaged as a result of the reforms. As an example, within the machine building industries, they have announced that special emphasis is to be given to new investment in machine tool, computer, instrument making, electrical equipment, and electronics. These have been identified by military leaders as being the keys to modernization of the defense industrial sector.

TARGETING QUALITY

Mr. Gorbachev has established ambitious targets to be met in the 12th 5-year plan. Aside from higher growth rates, priority has been placed on quickly improving the quality, reliability, and technological level of Soviet manufactured industry machinery. Fully 85 to 90 percent of all machinery is to meet what they call "world standards" by 1990. Mr. Gorbachev has stated that the U.S.S.R. hopes to move up to second-tier economic status by becoming competitive with Taiwan and Singapore in the export of manufactures.

POTENTIAL BENEFITS

Success of this program in meeting or approaching these targets would provide significant and tangible benefits to the Soviets:

They would reap a major propaganda victory which could partially rehabilitate the Soviet economic system as a model for developing nations.

They might begin to enter certain world markets as a manufacturers exporter, applying pressures on market shares and prices of Western producers of intermediate range goods.

The easing of economic constraints would allow Soviet leaders to face less difficult resource allocation decisions in the 1990's, permitting higher levels of spending on the Soviet military, client states, and perhaps global adventurism.

Also, Soviet prestige in international organizations would rise, along with opportunities to advance redistributionist international economic policies.

U.S. INTERESTS

There are many reasons why a more efficient and productive Soviet economy may not be in the best interests of the U.S. or NATO. We compete with the U.S.S.R. in precisely those areas where the Soviets would score the greatest gains from economic modernization.

In the area of strategic and conventional forces, the U.S. and NATO have been hard-pressed to keep up with the quantitative enhancement of Warsaw Pact capabilities dating from the 1970's. And we are finding it more difficult to maintain qualitative advantages over the Pact.

If, as in the past, the Soviet military establishment is the main beneficiary of economic dividends produced by successful reforms, NATO and the Western defense community will face a more powerful and dynamic adversary.

There is no historical precedent to infer a direct correlation between the process of internal reform and improved economic performance in the U.S.S.R. and greater moderation and cooperation in Soviet foreign policy. On the contrary, Soviet behavior in the international arena appears to be guided by perceptions of self-interest unrelated to domestic policies.

The underlying motives accompanying Soviet behavior will serve as the fulcrum for determining the West's response toward Moscow's economic outreach. Genuine signs of change from longstanding Soviet policies of hostile propaganda, political manipulation, and destabilizing active measures would certainly be welcome, but as yet there is no evidence of such policy redirection.

On the contrary, since Gorbachev's ascent to power, Soviet global activism, if anything, has intensified.

The West will need to address the issue of the role of the Soviet bloc and the global economy. Should we be assisting COMECON to develop export industries, if they then take market shares away from high-debt LCS's? How high should Soviet debt service burden be allowed to rise before it becomes a problem for Western commercial banks and governments? How can we prevent the U.S.S.R. from financing its global adventurism in Western capital markets?

INTERNATIONAL ORGANIZATIONS

Along with the internal economic changes encouraged by General Secretary Gorbachev, we have noticed a parallel effort to extend the U.S.S.R.'s influence in international economic and financial organizations. The more important of these are the GATT, the IMF, the World Bank, and various regional development banks. These are all creations of the postwar period which the Soviet Union rejected along with the Marshall Plan.

Soviet ability to participate effectively or constructively in international economic decisionmaking remains doubtful. Most international groupings, especially those involved in managing international trade, exchange rate, monetary and banking policy are grounded in market forces, and a huge closed nonmarket economy with few interconnections to the West would be difficult to absorb on economic grounds alone.

There is also the fear that the Soviets' desire for a place at the table stems more from a bent for political troublemaking than from any desire to participate responsibly.

Senator **Proxmire**. Secretary Wigg, could you wind up in about a minute? I want to get my questioning in if I can, and then go and then come back. If you could do that I would appreciate it very much. We have had your prepared statement in advance.

U.S. POLICY PRESCRIPTION

Mr. **Wigg**. I think the only other thing I would like to say, Mr. Chairman, is that whether he succeeds, the U.S. policy prescription essentially remains the same as it has been throughout the Reagan presidency: a conservative approach to economic interaction governed by mutual national interest.

Without improvement in Soviet behavior and improved Soviet international conduct generally, we believe future East-West relations should continue to be governed by strict national security criteria and Western self-interest.

[The prepared statement of Mr. Wigg follows:]

PREPARED STATEMENT

OF

DAVID G. WIGG

DEPUTY ASSISTANT SECRETARY OF DEFENSE
POLICY ANALYSIS

CONCERNING THE

NATIONAL SECURITY IMPLICATIONS OF SOVIET ECONOMIC REFORMS

FOR THE

SUBCOMMITTEE ON NATIONAL SECURITY ECONOMICS

OF THE

JOINT ECONOMIC COMMITTEE

UNITED STATES CONGRESS

SEPTEMBER 10, 1987

INTRODUCTION

MR. CHAIRMAN, I am pleased to be here today to participate in your hearing on the implications of Soviet economic reform. My name is David Wigg and I am Deputy Assistant Secretary of Defense for Policy Analysis in the Office of the Assistant Secretary of Defense for International Security Affairs. I want to express my appreciation to Mr. Kaufman for his assistance in helping to define the focus of our testimony today. I would like to begin by summarizing some thoughts that shape the perspective of my statement.

The foremost mission of the US Defense Establishment--to preserve and protect US national security--has, for the past forty years, mostly been directed against one principal adversary--the Soviet Union. In the years since World War II, the Soviet Union has evolved from a regional military power into a true nuclear superpower whose goals--and the policies flowing from those goals--directly threaten the security and global interests of the United States and its allies and friends. Most of the hundreds of billions of defense dollars spent annually by the NATO Alliance and friendly Western governments is geared to defend against the threat to our collective well-being from the Soviets and their client states and allies.

As with all countries, the growth of Soviet power and influence has been based on the development of the Soviet economy. Since the Bolsheviks began formulating economic policy in 1917, the Soviet approach to economic decision-making has been centrally-controlled, extensive development. For the past 70 years, the Soviet military-industrial complex has come first and the consumer last, in Moscow's determination to build the world's most powerful military force as the principal tool of its foreign policy.

While Moscow has indeed built a formidable military machine, the costs--including the opportunity costs--have been very high: vast quantities of inefficiently-used resources, a severely distorted economy, a third-rate civilian manufacturing sector (in terms of international competitiveness), the inability to consistently feed its people, and poor health standards, including among the developed world's highest rates of both infant mortality and abortion.

Lenin and early Soviet leaders recognized the value of commercial and financial relationships with select western "capitalists." Their initial efforts to benefit from western end-product technology, production knowhow and finance, have evolved into what is the largest, most systematic, and certainly the most successful program in history to skim the technological cream from an advanced economy to strengthen the less developed and inefficient Soviet command economy. Soviet success at this effort has exceeded Moscow's wildest dreams, and I will have more to say later about its important connection to General Secretary Gorbachev's reforms.

For decades, successive Soviet leaders perpetuated the ideologically-driven, militarily-focused economic and investment policies referred to above, which left the Soviet leadership constantly struggling to absorb Western technological change fast enough to keep Moscow from falling too far behind the West's rapidly advancing industrial development. The stresses on the system began to tell in the 1970's, however, as Soviet economic growth slowed, resulting in the large defense share of GNP growing even larger. By the 1980's, the Soviet leadership faced a potentially serious and far-reaching economic crisis that, unless resolved, could presage the eventual decline of Soviet power and global influence.

Soviet efforts to increase the efficiency of their economy have increased in recent years. General Secretary Andropov tried to raise the technical level of defense production. Mikhail Gorbachev has carried these efforts much further than his predecessors.

I would like now to summarize relevant US national security objectives and policies since 1981. I will then describe the economic challenges facing the USSR and the steps taken by the new leadership to overcome them. Finally, I will assess the implications for US national security should Mikhail Gorbachev succeed where other Soviet reformers have failed. Of necessity, my remarks will be directed to the militarily competitive aspects of the US-Soviet relationship, recognizing that other agencies of the US government bear responsibility for cooperative programs and diplomacy.

US SECURITY OBJECTIVES AND RECENT POLICIES

Since 1980, the success of the US and its allies in implementing an effective set of containment policies has undoubtedly contributed to the impulse for reform which has appeared in the Soviet Union. As pointed out by President Reagan, ". . .the threat from Soviet forces, conventional and strategic, from the Soviet drive for domination, from the increase in espionage and state terror remains great. This is reality. Closing our eyes will not make reality disappear."

Early in 1987, the Administration submitted a report to Congress which identified our primary national security objectives.* In our report, we pointed out that the US has chosen to meet the Soviet threat by:

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* "National Security Strategy of the United States," January, 1987

- Maintaining stable global and regional balances vis-a-vis the USSR and states aligned with it.

- Aiding threatened states in resisting Soviet sponsored insurgencies.

- Neutralizing the efforts of the Soviet Union to use intimidation, subversion and disinformation to increase its influence in the world and circumscribing the links between the USSR and its client states in the Third World.

- Ensuring that the USSR bears the brunt of its self-generated domestic economic shortcomings in order to raise the cost of excessive Soviet military expenditures and global adventurism.

Since 1981, the Administration has moved ahead with policies in each of these areas which have helped to check the advance of Soviet power which characterized the period between 1974 and 1980. One important means of accomplishing these goals has been the regeneration of US defense strength, which reversed the years of spending decline in the post-Vietnam period. A more specific example is NATO's deployment of Pershing II and ground launched cruise missiles, which frustrated Soviet efforts to achieve military hegemony in the European theater and was an important contributor to the current progress in arms control negotiations.

In the Third World, we have sought to aid states threatened by the USSR and its proxy forces. A bipartisan consensus for action has been forged to deal with aggression such as that against Afghanistan and Kampuchea, and we are engaged in efforts to bring peace and democracy to Central America, while removing destabilizing foreign influences.

In economic security, we have strengthened US and COCOM controls over exports, and thereby reduced the flow of militarily-sensitive technology to the Soviet Bloc. We obtained agreement within the OECD to end subsidized credits to the USSR. Soviet efforts to dominate Western European gas markets have been set back, perhaps permanently, and Soviet overtures to join global market-oriented multilateral economic institutions have been rebuffed.

THE SOVIET DILEMMA

Without greater sophistication in strategy and an improved ability to compete with the free world, Soviet leaders may have realized they were not likely to improve upon the military and geopolitical gains of the 1970's. Their problems, essentially were: (1) how to continue and accelerate flows of the needed technology, funding, and long-term cooperation from the industrial West to give the planned reforms muscle and staying power: while (2) maintaining Moscow's ambitious military programs and its intense global political/military and active measures campaigns against the US and its allies. In this regard, it is interesting to note that regardless of developments in the Soviet Union's relations with the West--where periods of detente alternated with periods of renewed confrontation--the Soviet military buildup forged ahead, to the point where parity with the West, if not superiority in key areas, has been achieved.

Throughout most of the post-war period, Soviet economic policy has been characterized by investment led growth, particularly in heavy industries and production for the military. The Soviet defense industrial base has evolved over the years from the technologically limited capabilities of the war years to a diverse, large-scale dynamic industrial complex today, capable of manufacturing a wide range of high-quality, sophisticated weaponry. Soviet military manufacturing capacity was increased by a significant 80 percent during the 1960's and 1970's. To illustrate the priority given to improving the technological sophistication of military production, the defense industrial ministries, as of 1986, absorbed almost 60 percent of the output of the Soviet machinery sector and almost 100 percent of additions to the machinery sector's labor force.

By the mid-1970's, signs of economic stagnation in the USSR began to appear. Annual growth rates of GNP are estimated to have averaged only 3.4 percent from 1971-1975, down from 5.3 percent in the 1966-1970 period. This slowdown in economic growth was worrisome because it increased the defense burden on the economy--potentially jeopardizing the success of the force modernization program and depriving the leadership of resources needed to sustain their growing global commitments. Faced with the need to cut either non-defense investment, civil consumption, or defense outlays, Brezhnev chose in 1975 to allow non-defense investment to bear the brunt of the cuts.

Meanwhile, the defense burden on the economy continued to grow. The share of industrial output devoted to the military ministries rose steadily from 10 percent in 1975 to 13 percent in 1980, and then to 16 percent by 1985. Soviet defense spending as a share of GNP continued to climb, reaching 14-16 percent of GNP in 1980 and 15-17 percent by 1985. Economic management and a series of poor harvests contributed to the slowdown, but excessive spending on defense was undoubtedly a major factor.

By choosing to reduce investment, Brezhnev and his immediate successors were essentially borrowing against the future in order to pay for current needs. This was a costly strategy for an economy that did not compare favorably in size or technological level with that of its principal adversary, the United States.

Brezhnev's investment strategy made little sense in terms of maximizing economic growth. The only visible payoff was the opportunity to use the decade of the 1970's--when US power had been battered by the oil crisis, Watergate, and the withdrawal from Vietnam--to try to achieve military supremacy over the West.

The Brezhnev military buildup coincided with the Soviet "breakout" in the Third World. While pursuing a policy of peaceful accommodation with the West, the Soviets took advantage of regional conflicts and political instability abroad to deploy military power far beyond their traditional sphere of influence. As was pointed out in a 1977 report by the Library of Congress, the shift to military globalism by the USSR suggested the emergence of a new imperial phase in Russian history.*

The Soviet objective in this surge of activism was to enlarge a community of nations that would form the nucleus of a Soviet world state. Vietnam and Cuba were associated with COMECON, and other client states such as Kampuchea, Ethiopia and Afghanistan were bound to the Soviet economy via long-term treaties and economic agreements. Soviet sponsored Cuban troops were in Ethopia and Angola, and the Soviets supported Vietnam's military presence in Kampuchea.

By the early 1980's, however, it became clear to Soviet leaders that Soviet influence, particularly in the economic domain, was on the wane. Not only had the Soviet economy stagnated; the communist LDCs were in even worse shape. Far from contributing to the reach of Soviet power, the communist LDCs became a significant drain on resources that were needed in the USSR itself. The Soviet mode of economic development characterized by central planning and an emphasis on heavy industry, had become discredited in the eyes of developing countries. The decision by the post-Mao leadership in China to relax controls on the economy and experiment with market forces was an effective alternative to Soviet economic orthodoxy. Given the stagnation in the Soviet economy, it was no longer a question of whether, but to what degree the Soviet Union would attempt to implement comparable reforms.

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* "The Soviet Union and the Third World: A Watershed in Great Power?," Congressional Research Service, May 8, 1977

THE GORBACHEV PROGRAM

When Mikhail Gorbachev took office in March 1985, the near- and long-term growth prospects for the economy were not bright. Inefficient management of the Soviet command economy and reduced levels of civilian investment had contributed to the technological obsolescent of the Soviet industrial base, which showed up in the declining productivity of labor and fixed capital. Agriculture remained a "black hole" for investment, as well as unproductive, redundant labor. Crop yields in poor-weather years were inadequate to meet Soviet needs. A potential energy resources crunch loomed over the horizon as productivity dropped in Soviet oilfields, threatening to deprive the USSR of its major export earner, at a time when world energy prices were falling and dependence on hard currency imports remained high.

The rise in living standards since the end of World War II began to taper off, weakening the legitimacy of the Soviet regime. Adult mortality rates began to climb, an unprecedented development for an industralized country that boasted of the achievements of socialism. Even the military had become restless, aware that continued problems in Soviet industry and society could undermine the USSR's hard-won status as a global power.

Gorbachev took charge, clearly determined to head off a clash between the competing Soviet needs of economic development on the one hand, and force modernization and global engagement on the other. He has attempted to do so by implementing in phases, policies designed to raise investment and productivity in Soviet industry and, to a lesser extent, Soviet agriculture. The major components of his economic policies include:

- pressing for greater work productivity and greater quality of output,
- encouraging the limited decentralization of decision-making authority, as evidenced by the proposed price reforms and the new limited independence granted some enterprises,
- raising investment in both civil as well as military industries, and
- fostering greater economic interaction with both East European and non-communist countries in order to upgrade the technological level of Soviet industries and thereby reduce the USSR's future dependence on imports of western products.

The scope of the announced reforms has aroused considerable commentary in the West. While ambitious in intent, they fall far short of the Chinese reforms or the Soviet New Economic Policy of the 1920's. However, they appear to represent a modification of the central planning model and state autarky that has characterized Soviet economic development since the time of Stalin.

We do not believe that the military will be disadvantaged as a result of the reforms. Within the machine building industries, for example, special emphasis is to be given to new investment in the machine tool, computer, instrument making, electrical equipment and electronics industries; which have been identified by military leaders as being the keys to modernization of the defense industrial sector. Investment in these industries is slated to grow about one and one-half times as fast as machine building as whole. The military ministries overall are expected to increase their consumption of industrial output from 16 percent to 18 percent by 1990, which is consistent with the rate of increase from 1970 on.

Gorbachev's foreign economic strategy is also designed with the goals of furthering both Soviet military capabilities and foreign policy objectives. Although certain foreign trade rights were extended to large production associations and enterprises, import decisions are to remain under state control. This would seem to preserve the central role of the Military Industrial Commission (VPK) in coordinating acquisitions of weapons-related technology. The anticipated increase in high technology imports resulting from any new joint ventures, licensing arrangements and co-production agreements, is intended to act as a stimulus to Soviet military production.

Although the Soviets have failed in Western Europe and Southwest Asia to enhance their leverage over the West's energy lifelines, they will probably look for new opportunities. Soviet activism in the energy area is assured by the USSR's interest in regional disputes and in the hard currency price of Soviet oil exports. The Soviets have worked opportunistically to exploit the problems of achieving an orderly resolution of the international debt crisis, despite the weak position of certain East European countries. We believe the Soviets and the Cubans will cooperate more closely in the future to exploit this potentially explosive issue in efforts to polarize debtors and creditors, particularly in the Western Hemisphere. Finally, we believe the USSR will continue to use its presence in international organizations to advance its anti-US agenda wherever possible. Recent disingenuous Soviet moves in the UN to link development and disarmament themes provide a case in point.

WHAT IF GORBACHEV SUCCEEDS?

Gorbachev has established ambitious targets to be met in the 12th five-year plan. Soviet plan targets imply an average annual GNP growth rate of about 4 percent during 1986-1990, which is to accelerate to a 5 percent average annual rate during the 1991-2000 period. Priority has been placed on quickly improving the quality, reliability and technological level of Soviet manufactured machinery. Fully 85-90 percent of all machinery is to meet what they call "world standards" by 1990. That Gorbachev is committed to this goal is reflected by his recent comments reported in the US press that the USSR hopes to move up to second-tier competitive economic status by becoming competitive with Taiwan and Singapore in the export of manufactures.

Gorbachev's success in meeting or approaching these targets would provide significant and tangible benefits to the USSR:

- The Soviets would reap a major propaganda victory which could partially rehabilitate the Soviet economic system as a model for developing nations.
- The Soviets might begin to enter certain world markets as a manufactures exporter, applying pressure on market shares and prices of western producers of intermediate range goods.
- The easing of economic constraints might allow Soviet leaders to avoid tough resource allocation decisions in the 1990s, permitting higher levels of spending on the Soviet military, client states, and global adventurism.
- Soviet prestige in international organizations would rise, along with opportunities to advance redistributionist international economic policies.

There are many reasons why a more efficient and productive Soviet economy may not be in the best interests of the US or NATO. The US competes with the USSR in precisely those areas where the Soviets would score the greatest gains from economic modernization. The Soviet leadership has, since World War II, invested a truly enormous amount of resources to build the most powerful armed force in the world at the expense of living standards of the Soviet people. In the area of strategic and conventional forces the US and NATO have been hard-pressed to keep up with the quantitative enhancement of Warsaw-Pact capabilities dating from the 1970's and are finding it more difficult to maintain qualitative advantages over the Pact. Within the past few years, thanks to President Reagan's US defense buildup, a rough parity between the military forces of East and West has been established. However, if, as in the past, the Soviet military establishment becomes the main beneficiary of the economic dividends produced by the reforms, NATO and the western defense community will face a more powerful and dynamic adversary.

There is no historical precedent to infer a direct correlation between the process of internal reform and improved economic performance in the USSR, and greater moderation and cooperation in Soviet foreign policy. On the contrary, Soviet behavior in the international arena appears to be guided by perceptions of self-interest, unrelated to domestic policies. For example, during the Krushchev years--a time of great internal change--the USSR embarked upon an activist foreign policy that challenged US interests, as evidenced by the Cuban missile crisis. The Brezhnev era was one of internal stagnation, yet the Soviets managed to achieve significant military gains in Southeast Asia, Africa, and Central America.

The underlying motives accompanying Soviet behavior will serve as the fulcrum for determining the West's response toward Moscow's economic outreach. Genuine signs of change from long-standing Soviet policies of hostile propaganda, political manipulation and destabilizing active measures would be welcome, but as yet, there is no evidence of such policy redirection. On the contrary, since Gorbachev's assent to power, Soviet global activism has, if anything, intensified. In the present environment, the Soviets can be expected to enhance their global activities as the reforms begin to pay off.

Improved manufacturing competitiveness is bound to show up first and perhaps exclusively in the Soviet arms export trade, where Moscow already has in place an extensive marketing network. Driven by a rising debt-service ratio and static earnings from oil sales, the Soviet arms export industries will be looked to for improved performance.

In addition to the increased earnings potential from Soviet sales of weapons, a stronger Soviet industrial sector will undoubtedly lead to expanded offers of economic assistance and cooperation to the Third World. Soviet economic aid programs have furnished little in the way of competition to the West in the past. From 1954 through 1985, total Soviet economic aid disbursed to the Third World amounted to about $16 billion dollars, compared with US assistance to the Third World in the post World War II period amounting to $156 billion.* But bolstered with more generous credit packages and more sophisticated development programs, the Soviets might be able to raise the ante in some Third World countries.

While increased effective developmental assistance from any source would tend to be viewed in a positive light by Third World recipients, traditionally, most Soviet economic aid has been narrowly focused on advancing Moscow's anti-western foreign policy agenda. Expanded Soviet activity in this area would come at a time when western aid programs, for the most part, are facing severe budgetary constraints. If western assistance does not keep pace with Third World needs, expanded Soviet aid would provide Moscow with opportunities to extend their political influence in the developing world. To the extent that Soviet economic assistance is funneled to the Communist LDCs, regional stability could be undermined by a more vigorous Soviet aid program.

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* CIA Handbook of Economic Statistics, 1986

The West will further need to address the issue of the role of the Soviet Bloc in the global economy. Should we be assisting COMECON to develop export industries if they then take export market shares away from the high-debt LDCs? How high should the Soviet debt service burden be allowed to rise before it becomes a problem for western commercial banks and governments? (Presently, the Soviet debt-service ratio is up around 25 percent, a sharp increase from two years ago and a level traditionally considered to be near the upper limits of the comfort zone for borrowing countries.) How can we prevent the USSR from financing its global adventurism in Western capital markets? In some ways, the USSR's growing dependence on trade with the West might actually create incentives for greater Soviet adventurism in regional disputes. For example, as exporters of strategic minerals, the Soviets are well-positioned to profit from political and economic turmoil in South Africa. Since Congress passed the Comprehensive Anti-Apartheid Act of 1986, US imports of antimony, chrome ore, ferrosilicon, and other strategic minerals from the USSR have increased dramatically. Given Moscow's hard currency squeeze, these new export opportunities offer some relief. But the US must avoid forming a strategic dependency on such trade.

As a major oil exporter, the USSR profited handsomely from the OPEC oil price hikes of 1974 and 1979. The Soviet Union is on record as having encouraged the Arab States to use oil as a weapon to influence the Middle East policies of Western Europe and the US. An additional benefit for the Soviets was the debt overhang for many of the LDCs that emerged out of the oil crisis. Rising LDC debt levels have strained North-South relations and provided Soviet/Cuban-backed interests in Latin America with an appealing propaganda theme for the economically disaffected.

SOVIET PARTICIPATION IN INTERNATIONAL ORGANIZATIONS

Along with the internal economic changes encouraged by General Secretary Gorbachev, we have also noticed a parallel effort to extend the USSR's influence in international economic and financial organizations. The more important of these groupings: the General Arrangement on Trade and Tariffs (GATT), the International Monetary Fund (IMF) and the World Bank (IBRD), the various regional development banks, are all creations of the postwar period and which the Soviet Union rejected, along with the Marshall Plan.

In those days of isolation, Soviet leaders abhorred compromising their ideological purity by admitting that the capitalist world had anything at all to offer them. In turn, the tendency in the West was to resist membership by non-market nations whose ideologically focused institutions would be difficult, if not impossible, to fit into the market mold of post-war economic reconstruction. Further, the USSR's xenophobia, autarchy and her status as an undeveloped country chilled Western interests in Soviet participation in the World War II victors' efforts to reestablish the world economy.

By the Krushchev era, in the late 1950's, some Soviets began to find these policies to have been short-sighted. As the Soviet Union grew in power and influence, it remained outside of the world economic organizations which were growing in effectiveness and dealing with international economic problems that also had an impact on the Soviet Union itself. In the mid-1980's, as Soviet oil export earnings fell and self-sufficiency became more unworkable, the USSR again began to explore the possibilities of joining the GATT, the IMF, the IBRD. Having failed to join at the outset, she found herself knocking at the door or organizations which had become both strong and global in reach with minimal participation by non-market economies and which were, and are, reluctant to tamper with a proven and successful formula.

Today, the Soviet Union's ability to participate effectively or constructively in international economic decision-making remains doubtful. Most international groupings, especially those involved in managing international trade, exchange rate, monetary and banking policy, are grounded in market forces and a huge, "closed," non-market economy with few interconnections to the west would be difficult to absorb on economic grounds alone. In addition, there is the fear that the Soviet Union's desire for a place at the table stems more from a bent for political troublemaking than from any desire to participate responsibly. Increasingly, cooperation and conflict resolution in international trade and financial spheres (i.e. international trade and debt negotiations) are based on mutual restraint and repudiation of nationalistic self-interest. The Soviets have a long history of mercantilist trade behavior and continue to use disinformation and active measures to disrupt and undermine western economic cooperation.

On a very practical level, some nations feel that the executive staff positions which the USSR could claim in international secretariats and governing bodies could be used to create organizational mischief and to reduce the influence (and the number of staff jobs) now enjoyed by smaller nations. Moscow's less-than-edifying behavior in other international organizations such as the UN and its constituent bodies, stands as an example. Finally, up to now, Soviet clients in Eastern Europe have had mixed success in entering groups such as the IMF and World Bank. Member nations have cited the difficulty of ingesting ideologically-driven non-market economies as a central problem.

Similarly, USSR representation in the IMF, IBRD or the Regional Banks could be used to favor exchange rate or lending policies that are contrary to market-oriented goals, and are designed to strengthen regimes hostile to the West or to encourage regional insurgencies in recipient nations. Such membership under present circumstances is not in the best interests of Free World economic, political and security goals.

We can see an increasing Soviet interest in the world economy and we have ample experience with the disruption that a determined Soviet presence can create in international organizations. We must remain sharply aware of the security implications for ourselves, our allies and our other free world partners in introducing a hostile, economically indigestible and politically adventurous actor in global economic councils.

THE HIGH COSTS OF EAST-WEST TECHNOLOGY TRANSFER

The continuing and intensifying squeeze on Soviet resources, capital and labor in coming years, virtually guarantees that Moscow will accelerate its drive to acquire and assimilate Western technology. Soviet military requirements dominate the USSR's trade in sophisticated industrial goods with Western nations. Technology imports and industrial espionage are directed by the most powerful organization in defense production--the Military Industrial Commission of the Presidium of the Council of Ministers (VPK). The VPK coordinates the development of all Soviet weapons as well as the Soviet national-level program to acquire Western technology. The State Committee for Science and Technology, in coordination with the Ministry for Foreign Trade, the KGB and the GRU (their military intelligence organization), acts as a collector and processor for the technology acquisition program. The VPK also relies heavily upon other Soviet organizations such as the Academy of Sciences, as well as the East European intelligence services, for assistance.

I want to emphasize the important role in these illegal acquisiton efforts played by the Ministry for Foreign Trade, which administers and operates hundreds of foreign trade organizations and firms around the world. As pointed out in a recent US Government report on the problem, this global presence and the ministry's official duties related to technology and transportation make it a practical cover organization for hundreds of KGB and GRU officers, and during the late 1970's and 1980's, it played a major part in illegal trade activities.

Due to the enormous sums spent on military R&D and production, and the success of the technology acquisition campaign initiated by General Secretary Andropov, the Soviet defense industries moved steadily ahead of their civil counterparts in efficiency and the quailty of output. The most compelling evidence is offered by the export performance of the Soviet weapons industry, which has provided approximately 20 percent of total Soviet hard currency earnings since 1981. In contrast, other Soviet manufactured exports have, for the most part failed to win a share of international markets.

Although our COCOM export controls are effective in keeping the most sensitive technologies out of the hands of our adversaries, license denials cover only a small part--less than 1 percent--of the COCOM-member countries' exports of high technology to the world. This means the Soviets are able to acquire legally and illegally, massive amounts of sophisticated equipment and technical data with military applications.

The opening up of East-West commercial ties would provide a windfall for the Soviet and East European intelligence services and their technology acquisition programs. The VPK would be able to expand dramatically its network of Western front companies. Hundreds of Soviet nationals could travel to the US each year under private sector auspices. Many of these visitors would be working for the KGB or GRU. No mechanism exists in the United States government to evaluate the security risks associated with business visitors from the USSR. We also receive up to 6,000 business visitors from East European countries, and many of them obtain visas which permit multiple entries during the course of the year, which adds to the problem.

The one-way flow of advanced technology from West to East, combined with the more rapid diffusion of Western technology as a result of the Soviet industrial cooperation proposals, ensure that the Warsaw Pact forces would benefit greatly from any increase in East-West trade.

The arms control negotiations underway to eliminate intermediate-range missiles highlight this dilemma for the US and NATO. If this category of forces is eliminated, the importance of our conventional deterrent will grow. But keeping up with the massive growth of Soviet weapons production may not be possible if West to East transfers of advanced technologies accelerate significantly. As Secretary Weinberger has stated: "We recognize the impracticality of trying to match the Soviets plane for plane or tank for tank. We have chosen to rely on superior technological capability to produce the force multiplier effects that enable us to fight outnumbered and win." In other words, we rely on superior technology, knowhow, training and systems effectiveness to offset Soviet numerical advantages.

We and our allies have invested heavily in upgrading our conventional forces in recent years. For example, total US appropriations for R&D and procurement--mostly for conventional forces--has averaged $122 billion over the past three years. But our gains have been offset, in part, by the great success of the Soviets in acquiring and applying to their weapons systems the technology we create and use in ours. To provide some examples:

- The illegal transfer of advanced propellor milling equipment to the Leningrad shipyards will enable the Soviets to reduce significantly the noise level of their submarine fleet.

- The documentation on the F-18 fire control radar served as the technical basis for new lookdown/shootdown engagement radars for the latest generation of Soviet fighters.

- Sophisticated laser range finders on Soviet tanks are carbon copies of US devices. This technology transfer was particularly worrisome to NATO planners due to the strong numerical advantage in tank forces enjoyed by the Warsaw Pact.

- The Atoll air-to-air missile and the US Copperhead missile were copied by the Soviets.

What can we conclude from these examples of the compromise of major Western weapons technology? One of the traditional arguments in support of expanding East-West trade has been that encouraging Soviet dependence on western products will serve to improve the atmosphere in East-West relations, generally. While the prediction of long-term improvement in relations tied to trade has proven incorrect, an ironic trade dependence has formed--Soviet dependence on US military and dual-use end-product technology and production knowhow. The Soviets have dedicated an enormous amount of resources geared toward the systematic tapping of Western technological innovation. Their efforts have been amply rewarded. We estimate that hundreds of Soviet weapons systems have thus benefited.

There is more to the cost of this technology loss than just savings in Soviet man-years or rubles, in Soviet research, investment and production efficiency, and qualitative gains in the effectiveness of Soviet weapons systems. A cost estimate must also take into account the discount factor against US and Allied annual R&D and procurement costs, commensurate with the relative degradation of US and NATO weapons in the field due to resulting qualitative Soviet gains. It almost surely would run in the tens of billions of procurement dollars over time--a huge figure when compared to the trickle of profits that accrue to the handful of US companies engaged in manufactures trade with the Soviet Bloc, which serves as a principal platform for illicit Soviet technology acquisition.

There is thus, a direct linkage between the amount we must spend on developing and fielding ever better weapons systems and our success in keeping militarily useful technology out of the hands of our adversaries. As we enter the production/

procurement cycle of another new generation of weapons technologies (SDI, low observables, new materials, advanced electronics) we must ensure that all Americans, Allies and COCOM partners, and Free World industrializing countries, better understand this linkage. Critical budgetary limitations and security interests shared by these countries underscore that need.

Because of the linkage to our defense spending, the Soviet leeching of our sensitive technologies is a millstone around the neck of every taxpaying American. During the past two years, Congress has made deep reductions in the President's Defense budget requests. If Congress is at odds with the Administration's views on defense spending, then it should not aggravate matters by loosening export controls, thus making it easier for Moscow to acquire the near real-time technological means to match or defeat US weapon systems in the field.

US POLICY

Whether or not Gorbachev succeeds in strengthening and streamlining the Soviet economy, the US policy prescription remains the same as that followed throughout the Reagan Presidency--a cautious, conservative approach to economic interaction, governed by mutual interest. In view of our security concerns, the US and its allies have exercised prudence in commercial, trade and financial relationships with the Warsaw Pact nations. Absent consistent, demonstrable improvement in Soviet human rights practices and emigration, cessation of dissemination of anti-US propaganda and disinformation, and improved Soviet international conduct generally, we believe future East-West relations should continue to be governed by strict national security criteria and western self-interest.

Over the past five years, the NATO allies have continued to cooperate successfully to implement a consensus on a prudent economic relationship with the Soviet Union and Eastern Europe. Individually and as a group, we have made significant headway in meeting our goals and continue to take effective actions to implement these policies. We will continue to adhere to key aspects of these policies by:

- conducting non-strategic trade with the East based on a balance of advantges;
- avoiding subsidizing the Soviet economy through preferential terms of trade or financing;
- restricting transfers of equipment, products and technology which would increase Warsaw pact military capabilities; and
- avoiding increased dependence on the USSR as an energy or strategic minerals source.

I want to close by acknowledging the gap in our knowledge of the workings of the Soviet economy, particularly the defense sector. The gaps exist not because we have no desire to perfect our understanding, but because much of the data is still wrapped in secrecy. Perhaps the Soviets can forgive us for making "worst case" assumptions in this situation. Speaking for the defense community, I can say it would be imprudent to do otherwise.

President Reagan offered an important suggestion the other day when he called on Soviet leaders, in the spirit of Glasnost, to open up their defense budget and programs to public scrutiny, as we do in the west. By doing so, the Soviets could go far in revealing their intentions in the relationship with the non-communist world. If Glasnost is truly underway, let it start here.

EFFECTS OF U.S. POLICIES

Senator **Proxmire**. Thank you very much, sir. I am going to suggest to the committee that we have 5 minutes for questioning and we will have second rounds if necessary, if members would like that.

We do have a very distinguished panel of three other experts who are going to testify immediately after you so that we can move right ahead.

In your prepared statement, Secretary Wigg, you say that President Reagan's policies, including the defense buildup, contributed to the impulse for reform in the Soviet Union. You then show how Gorbachev's success would benefit the Soviet Union and state that there are many reasons why a more efficient and productive Soviet economy may not be in the best interests of the United States or NATO?

Are you saying in effect that U.S. interests would have been better served if we had not helped to provoke that kind of Soviet economic improvement? Was it against our interests? Should we have followed some other policy to tend to discourage the Soviet Union?

Mr. **Wigg**. I think it was an inescapable result of the policy of trying to contain Soviet behavior and trying to contain their ability to expand their military interests.

Senator **Proxmire**. But in doing so, if I follow you correctly, we did make it necessary for Gorbachev to pursue policies which have strengthened the Soviet economy and will strengthen their military forces and strengthen them as an adversary.

Mr. **Wigg**. It isn't surprising that he would do what he could to improve his relative position back home, and they clearly understand the gravity of their situation. I don't know that there was really any way to avoid their realization of that fact.

However, the question remains: What should we be doing to participate in this effort? How much should we play an active role in helping to underwrite their ability to grow more rapidly, to participate internationally?

U.S. POLICY PRESCRIPTION

Senator **Proxmire**. Are you saying, then, that we should try to impede the success of their economy?

Mr. **Wigg**. I think that we should be conservative. I think we should be cautious, and we should operate in our own self-interest.

Senator **Proxmire**. How do we do that?

Mr. **Wigg**. I think we do that by not cutting COCOM's export controls, for example. I think it is very important, particularly with the problem of the cuts in defense, that we do not exacerbate that situation by reducing the amount of coverage we have on sensitive technologies.

I think that we should encourage our allies to be cautious in their expanded contacts and relationships with the Soviets.

ARMS CONTROL

Senator **Proxmire**. How about the area of arms control? To the extent that we pursue an arms control policy that is successful and that both sides limit the amount of the resources they put into their military, does that strengthen in your judgment the Soviet Union and their ability eventually to develop a capability, even though the arms control might restrain it in some respects? Does that make arms control something that we should be also cautious about or not?

Mr. WIGG. I think the practical fact is that arms control discussions at this point center around weapons systems that are relatively inexpensive. The principal cost of our defense budget is in the conventional area.

Senator PROXMIRE. That is exactly right. And of course, as you know, Mr. Gorbachev has suggested that we should consider conventional arms control limits, including reducing personnel on both sides, reducing artillery, reducing ships and so forth, which could have an enormous effect in holding down the drain of military for both countries.

Is it your implication that we should be careful about this because it would perhaps strengthen the Soviet Union more since they have a weaker economy, and that it would strengthen this country—or not?

Mr. WIGG. No, I don't think so. I think genuine, significant cuts in conventional weaponry would place real limits on the Soviet ability to pursue the global expansion that they have.

Senator PROXMIRE. Would you agree that the United States does not have the leverage to prevent the reforms from going forward, and that we should pay more attention to what the consequences might be and what adjustments we should make?

Mr. WIGG. That is correct. Yes.

MILITARY DOCTRINE

Senator PROXMIRE. Some experts maintain that the reform movement has already influenced Soviet defense policy. For example, the Soviets are now talking about military sufficiency as their goal rather than parity, and are hinting that sufficiency might be less than parity in some areas.

Do you see this or any other change in military doctrine taking place?

Mr. WIGG. I would be very cautious about interpreting open literature comments by Soviet officials in this area. They have for many decades used disinformation in this way fairly effectively.

I would say, however, that I think Soviet military policy has probably done as much to influence reforms as the other way around, as you indicated, because I think the Soviet military is acutely aware of their limitations in the future in terms of their ability to keep pace with the West without a more dynamic, synergistic economy across the board.

There is nothing they would like more than to be self-sufficient in developing a military technology, but they have not been able to achieve that, which is why I have discussed at some length the technology transfer implications.

GOAL OF REFORM

Senator **Proxmire**. Which is more important for the Soviet Union—to improve their technology or to free resources so they could just put more muscle, more resources into their military efforts?

Mr. **Wigg**. I think the goals of the military policies they follow are to advance their foreign policy interests, however that may be done.

Senator **Proxmire**. No, that wasn't my question.

My question: Is it more important for them to improve their technology perhaps through beg, borrow, or stealing the technology from the West, or is it more important simply for them to have less pressure on their available facilities so they can put more into the military?

Mr. **Wigg**. I would say the long-term emphasis on acquiring technology or being technologically competitive would fall more in the former. I think that they are overwhelmingly focused on the relative relationship.

Senator **Proxmire**. My time is up. We will proceed on the basis of going back and forth with the first person here, who is Congressman McMillan. And I am going to ask Congressman Scheuer to chair while I am gone, as the one member of the majority, if that is all right with you. I will be back quickly.

DEFENSE BURDEN

Representative **McMillan**. Thank you very much for your testimony.

To get things in perspective a little bit, what is your estimate in the most recent full year for which we have an accounting as to the Soviet commitment to defense relative to their gross national product?

Mr. **Wigg**. In terms of the percentage?

Representative **McMillan**. Percentage.

Mr. **Wigg**. It is running about 16 percent, 16 to 18 percent.

U.S. DEFENSE EXPENDITURE

Representative **McMillan**. And that would be in contrast to about 6.7 to 6.8 percent in the United States?

Mr. **Wigg**. That is right?

Representative **McMillan**. And probably the highest NATO participant, other than the United States, would be what, 4.5 percent, something like that? Maybe a little higher in the case of Greece, but for perhaps different reasons.

Mr. **Wigg**. Yes.

Representative **McMillan**. So trying to translate that into terms that we can understand, if we were spending that percentage in the United States, then our defense budget would be on a magnitude of perhaps $800 billion a year?

Mr. **Wigg**. Yes.

Representative **McMillan**. Which would have a rather extraordinary impact on our capacity to do other things?

Mr. **Wigg**. Yes.

ECONOMIC IMPACT OF DEFENSE EXPENDITURE

Representative **McMillan**. $300 billion has a rather extraordinary impact on our capacity to do other things. I think maybe some of the impact of those things tend to magnify themselves geometrically when applied to other segments of society. For example, its impact on technology might be on a magnitude far greater than 16 percent, proportionately speaking. In other words, it may well dominate that technology, absorb all of their resources.

Do we have a way of trying to quantify that in some manner?

Mr. **Wigg**. I think what we have seen is the flows of labor and capital and resources into that sector have been the best that the Soviets have. I think virtually all of the additions to labor, labor shortages are becoming a bit of a problem, have been flowing into the defense industry in the machine-building sector, for example.

So what you have is a siphoning off of the best resources and so on.

Representative **McMillan**. And that is both in human terms and in skills and natural resources and so forth, capacity?

Mr. **Wigg**. Yes. Their economy is roughly half as large as ours, but they are compelled to compete with us militarily on a global basis and the demands are extraordinary, particularly with their inefficiencies, bureaucracy and overall technological inferiority.

Representative **McMillan**. I think there are significant changes that are occurring or attempts are being made to promote significant change in the Soviet Union. I do not tend to think they are driven by any change in political philosophy or ideology. I think they are driven by other more pragmatic reasons and that they are pretty darned compelling.

I don't pretend to be an expert on the Soviet Union. I have been there for 4 days recently and I have only seen one little piece of a massive country. But in terms of its lack of advancement in a lot of critical areas, they are pretty apparent to any visitor at about any point in the Soviet Union that wants to take a look at it.

I think there is a consciousness that that exists within the Soviet population and even perhaps within its leadership that lies behind the change that has taken place.

So my feeling is that maybe it is a little too early to pass judgment on it. Would you basically agree with that and that maybe there are good, solid, hard-nosed reasons why the Soviet Union is seeking change and that that change has the potential to work in our interest, not just their interest?

Mr. **Wigg**. I agree with you that it is premature for us to tell the extent to which these reforms will be fully implemented, to the extent to which they will be effective, will permeate within that somewhat Byzantine economy.

It strikes me that anything that moves in the direction of improved efficiency, higher labor productivity, more efficient use of resources in an economy that is constrained, is positive. I don't see how Mr. Gorbachev can lose, frankly.

U.S. INTERESTS

In terms of working in our interest, I think we have to distinguish between the generics of the system and its ability to grow more rapidly or use resources more efficiently and their foreign policy, their intentions with respect to the United States, and their activities in various regions of the world which continue to be inimical to our interests.

We are dealing with a government that has propagandized around the world that the United States invented the AIDS virus and that we are spreading this to further our foreign policy goals. This is a very difficult thing to deal with when you are talking in terms of a more dynamic Soviet economy serving the interests of the West.

REDUCING DEFENSE GROWTH

Representative **McMillan**. Yes, we are going to have to deal with that kind of thing, but to the degree that the Soviet Union is driven by a need to reduce the allocation of resources to the military in order to advance technologically and perhaps even in providing a wider measure of consumer benefits, if you want to put it that way, to its people, to deal with problems of its own basic infrastructure which is shabby in many respects, it seems to the degree that they do that, we benefit.

Now, we can argue about whether or not they are going to be successful in opening up their society, but to the degree that they reduce their commitment to defense, I can't see that that works to our detriment.

Mr. **Wigg**. I think we have to be careful when we look at the announced reforms in looking at the impact on the economy and the defense sector. It is our opinion that defense will not be adversely affected by the economic reforms; that their share of the gross national product will continue to rise in a way that is consistent with the overall trend since 1970.

They feel that they need a greater dynamism in the military sector in the 1990's and beyond in order to continue the policies that they have followed for some time.

In terms of the idea that consumerism will become a significant factor in the economy, resources will flow away from the military and into the domestic side, we really don't see evidence that that is the case. We think that the military is probably one of the sponsors and supporters of this entire reform effort because it serves their long-term interests. They don't want to be dependent on Western technology in order to be militarily competitive. I think they find that very uncomfortable.

The system that they have for legal and illegal technological acquisition is a very complex and uncertain and difficult one. They are very successful at it, but to rely on that in the long term I think would be probably poor policy in their view.

Representative **McMillan**. Thank you. My time has expired.

Representative **Scheuer** [presiding]. Congressman Fish.

FUTURE U.S. DEFENSE EXPENDITURE

Representative **Fish**. Mr. Wigg, I would like to return to when Chairman Proxmire was asking you about the relationship in this whole matter that you have explored, the economic reform and the

Western security requirements, the relationship of U.S.-Soviet arms control negotiations.

You did indicate that what was in the cards in the near term was a relatively low-cost item as far as U.S. defense budget.

Looking down the road, if this administration or a future administration continues to negotiate arms control agreements and we get to really—some of the proposals, 50 percent of all strategic nuclear—do you anticipate that the U.S. defense budget would have to go up substantially because of the greater reliance on conventional forces instead of a nuclear deterrent?

Mr. WIGG. That is certainly a possibility. How it will play itself out is rather difficult to forecast. Defense costs are rising and without really significant cuts in conventional forces, which is where we spend the bulk of our money, I find it difficult to imagine a significant reduction in the resource flows.

CONVENTIONAL BALANCE

Representative FISH. But I just get a hint that perhaps you think we are running quite a risk in pursuing arms control in the light of the enormous edge that the Soviet Union has in conventional forces. Is that a fair statement?

Mr. WIGG. Well, we are quite concerned about their ability to threaten in certain theaters, in the absence of certain types of traditional weapons, nuclear weapons. Certainly the NATO situation is affected.

I think what we are trying to say is that the relationship is complex. It has various elements that affect our ability to protect our own national security and to minimize our defense spending.

If we cut nuclear weapons in various types of successful negotiations and we are left with a heavy reliance on conventional forces, the fact that a significant portion of our cutting edge technology winds up in the Soviet military sector and is incorporated, in some cases rather obviously, into Soviet weapons, and at the time we are under severe budget constraints in terms of our own military spending, then you start having to discount, as I mention in my testimony, you literally have to discount the amount of procurement we spend annually to take account of this technology loss and the degradation to our own weapons relative to Soviet weapons.

When we create technologies and infuse them into the flow of the development of equipment and these technologies wind up in Soviet hands, and they do the same thing, then this money is not particularly well spent.

So I think just focusing on one aspect of the issue is not really necessarily very helpful. You have to look at all these things as they interrelate.

Also another factor is Soviet policy and their intentions in this area. They are continuing to be extremely aggressive in many parts of the world and they continue to want to project their forces farther and father from the Soviet Union. This costs a great deal of money and requires an enormous effort really. So Soviet intent is a factor.

SDI

Representative **Fish**. If I have another minute, on this whole question of technology, it has been claimed by some people that the Soviet real fear of our development of the SDI program is not that it would produce a perfect nuclear shield, but rather that it will entail technological breakthroughs and spinoffs that will permit Western economies to move even farther ahead than the Soviet Union.

What is your opinion of that statement?

Mr. **Wigg**. I think that is a plausible statement. I would not be surprised if that were the case. As much as they have disinformed the public with respect to their ability to counter our strategic defense technologies—and I say "disinformed" because for my own view I don't believe they have the capability to counter in real time some of the projected technologies that we are dealing with—I think this is a real concern to them, yes.

Representative **Fish**. Thank you.

Representative **Scheuer**. Congressman Wylie of Ohio.

Representative **Wylie**. Thank you very much, Congressman. I found it necessary to be a few minutes late and apologize for that. I have an opening statement, Congressman Scheuer, which I would ask unanimous consent be included in the record right after the opening statement of Chairman Proxmire.

Representative **Scheuer**. Without objection, so ordered.

GORBACHEV'S REFORMS

Representative **Wylie**. The question about the Soviet economy and the prospective changes, what are the main tendencies associated with the Soviet economic reform?

For example, are we talking about serious efforts now being undertaken by Gorbachev and his new circle of advisers to expand the role of the private sector and to decentralize decisionmaking or, alternatively, is Mr. Gorbachev thinking about less ambitious undertakings such as greater autonomy for factory managers within an overall context of centralized decisionmaking?

Mr. **Wigg**. As I said earlier, I think he is thinking in terms of phrases and I think he has to, as he goes along, look at what is coming back at him in terms of how effective they are, how capable they are of implementing what they have in mind and working, in a sense, a two-way approach.

In terms of Soviet planning, the enterprises will produce a portion of their output in compliance with mandatory state orders. I think that will continue. But they will be given greater latitude in determining the remainder of their output.

In terms of prices, the system will be changed so that the number of fixed prices will be greatly reduced and will include what they refer to as only the most important products. There is a certain vagueness about some of these things that gives them substantial latitude in the ability to adjust.

In terms of supply only what they call "scarce" producer goods will continue to be rationed by the state. Other supplies are intended to be distributed through a wholesale trade system.

In terms of finance and credit, they hope to move to a situation where enterprises will, as they say, bear full economic responsibility for the results of their own decisionmaking. Investment will be financed, hopefully less through budget allocations and more through bank credits.

As far as wages, ceilings on wages will be eliminated and a general reform of wages will be implemented, again somewhat openended.

POTENTIAL COSTS OF REFORM

Representative **Wylie**. As a kind of a followup to that, do we have—and I have a feeling that the answer might be no—but do we have any reliable estimate of the economic and political costs which might be associated with the Gorbachev reform proposal?

What I am suggesting there is that reports coming from the Soviet Union strongly suggest that unemployment could significantly rise in the event Gorbachev and his manager succeed in closing down hundreds, if not thousands, of poorly run Soviet enterprises. This is a question I saw on a talk show not long ago.

In view of the U.S.S.R.'s previous commitment to a so-called full-employment policy, what might be the economic and political impact of such a dramatic policy shift?

Mr. **Wigg**. In some sense, that is a $64,000 question. I don't know that we really know.

Representative **Wylie**. Congressman Fish says it might be the $64 billion question.

Mr. **Wigg**. To the extent that the reforms do result in the transformation into some variation on elements at least of markets operating, I would think that unemployment would fall out of this. I don't see how it can be avoided.

If they can solve that problem, I think maybe we ought to pay attention.

U.S. INTERESTS

Representative **Wylie**. Do you think that the West, or the United States in particular, will derive any advantage from this new Soviet policy which, over the long term, might develop a more flexible, competitive Soviet economy, more competitive to our own?

Mr. **Wigg**. Under the best of circumstances, we see a great number of disadvantages. They are not necessarily the kinds of disadvantages that directly threaten our national security, but they introduce a player into the global economy under maximally successful reform policies that we would have to learn to cope with.

INTERNATIONAL ORGANIZATIONS

I am just trying to imagine the Soviets with the types of things they pull in the United Nations and other international fora, in the IMF, in the GATT, dealing with Moscow on some type of dumping case. It is just an enormous entanglement to think about. We have a great deal of trouble with these guys now in the limited economic areas with which we deal with them.

Just the comparison of the two legal systems gives you some idea of the difficulties, just definitional difficulties.

GLASNOST' CONCEPT OF LIBERTY

Representative **Wylie**. In this week of celebrating our bicentennial of our Constitution, which was developed to secure the blessing of liberty to ourselves and our posterity, is there any of that kind of thinking in the glasnost' concept of liberty?

Mr. **Wigg**. I don't really want to speculate on that.

PLANNED PUBLICATION OF DEFENSE BUDGET

Representative **Wylie**. Thank you, Congressman. My time is up.

Representative **Scheuer**. Thank you, Congressman Wylie. Mr. Wigg, you have noted that President Reagan has urged the Soviets to publish their defense budget. I am sure you are aware of the fact that they have said they intend to do that as soon as price reforms are implemented.

What would be the significance of their taking this step, and would it change anything in our Defense Department's assessment of what Gorbachev is up to, his policies, his intentions?

Mr. **Wigg**. I think it is a matter of matching up what we have assumed for a long time and what we have learned or believe we have learned through the gathering of intelligence, and then coming to analytical conclusions based on that intelligence, versus what hopefully would be the real thing.

First of all, you have to make a leap of faith here in believing that what they publish would in fact be the extent of this resource allocation. This is very difficult to determine. I think in the short run, there is certainly a propaganda advantage to this.

Representative **Scheuer**. Why are we urging them to do it then?

Mr. **Wigg**. I think the more that they share with us, legitimately share with us, not offer us something that is just a public relations ploy and that continue to mask expenditures, if they come clean and give us, to the extent that we do, actual numbers, it enables us to deal more forthrightly with the Soviets.

I think it would be an indication of positive intent. I would interpret it that way.

SLOWDOWN IN GROWTH OF MILITARY EXPENDITURES

Representative **Scheuer**. Some of the experts out there are interpreting the slowdown in the growth of military expenditures in the Soviet Union since more or less 1975. They argue that this is being continued by Gorbachev and this project is likely to continue over the next few years. From this they extrapolate that there is likely to be a shift from the military to the civilian sector in conjunction, more or less, with Gorbachev's announced industrialization and modernization program.

How does this all fly with you?

Mr. **Wigg**. I think to the extent that the economy grows less rapidly, it sharpens the competition among the demanders of resources. How that works out in actual fact of allocation is difficult to say.

The influence of the military is certainly very much pervasive. Although Mr. Gorbachev would probably have his preferences in terms of overall investment decisions and resource allocation, it's a question of whether they can come up with the logical imperatives that they have to deal with as a construct out there from which to make decisions.

They may conclude that there are forces at work that require them to work in a certain direction. So decisionmaking is difficult to predict here. Just that the squeeze on resources makes things more difficult.

Representative **Scheuer**. Does anybody else have any questions?

SOVIET AD IN WALL STREET JOURNAL

Representative **McMillan**. I have one additional question. When I was in Europe, by the way, last week, this ad came out in the Wall Street Journal, which is 10 pages of advertising by the Soviet Union. This was a rather extraordinary departure. Was it run in the United States?

Mr. **Wigg**. Yes.

TRADE OBJECTIVES

Representative **McMillan**. And they are talking a lot about trade and so forth in here. You touched upon the Soviets' admiration of Taiwan and Singapore in terms of export industries they have developed.

Do we really have any evidence at this point of their targeting segments of the world market, or even the U.S. market, that they would like to try to penetrate? One of the most impressive things I saw there was the penetration of Pepsi Cola in the Soviet Union. You sit down at the dinner table and a bottle of Pepsi goes on the table, by order of the state. Somebody did a good selling job there.

I wonder if they have advanced to the point where they have targeted segments of the U.S. market that they would like to capture from an export standpoint?

Mr. **Wigg**. I think in terms of expanding their involvement in the world economy, there will probably fall out certain comparative advantages for certain types of manufacturers.

I think probably in their dreams, they may have targeted or anticipated the potential to move into certain markets. One thing is clear. They do not want to rely on oil and gas and timber and gold and so on to earn hard currency. They would like to get into the manufacturers business. Value added is the name of the game, and we shouldn't underestimate their potential to do that with successful reforms. The Soviets have performed amazing economic feats over the last 70 years.

But I don't have any particular evidence, other than a general sense of things that they have talked about. Where they can earn hard currency they will, I think.

Representative **McMillan**. I had heard, for example, that they may well be dumping a particular textile commodity in the United States at the present time. Have you heard anything to that effect?

Mr. **Wigg**. No, I haven't.

Representative **McMillan**. I yield back. Thank you.

Representative **Scheuer**. Thank you very much, Mr. Wigg. We thoroughly enjoyed your thoughtful testimony.

We will now hear from a panel of well-known, distinguished economists and experts on the Soviet Union. So if the panel will come to the witness table: Mr. Abraham Becker of the Rand Corp.; Professor Murray Feshbach, Georgetown University; and Professor Marshall Goldman of Wellesley College and the Harvard Russian Research Center.

We are delighted to have you here, all of you.

What we would propose is for each of you to talk informally for about 10 minutes, summarize your prepared statements which will be printed in full at this point in the record, and then I am sure that Senator Proxmire will be back and we will all have some questions for you.

So why don't we go from left to right? Professor Marshall Goldman.

STATEMENT OF MARSHALL I. GOLDMAN, PROFESSOR OF ECONOMICS, WELLESLEY COLLEGE, AND ASSOCIATE DIRECTOR, RUSSIAN RESEARCH CENTER, HARVARD UNIVERSITY

GORBACHEV'S DILEMMAS

Mr. GOLDMAN. Thank you very much. My name is Marshall Goldman from Wellesley College. My prepared statement has been submitted and I will not read it. I will make some extracts from it. I won't focus on the changes themselves. They are spelled out in my statement and have been discussed already to some extent.

What I will do in fact then is concentrate on some of the problems that I see Gorbachev facing. I am not going to focus on the perestroika, the reforms. I am going to talk about the dilemmas that the leader and the leadership have to face and suggest just how difficult it is going to be for him to do what he wants to do. I will go through them rather rapidly, but I hope I will be slow enough so that they will be understood.

RESISTANCE

I would like to begin with a story that I heard in the Soviet Union this summer. There was a summit meeting between President Reagan, Prime Minister Chirac, and General Secretary Gorbachev and they started complaining about their mutual problems, and Chirac said, "Oh, do I have a serious problem. I have 10 mistresses. One of them is untrue; I don't know who."

And Reagan says, "You think you've got a problem. I have 10 advisers. One is a member of the KGB; I don't know who."

And then Gorbachev said, "You think you've got a problem. I have 10 ministers working on the reform. One's on perestroika, and I don't know who."

What I am trying to say is that the magnitude of his problem is such that there is a good deal of resistance in the system, and that is reflected in something that I would like to read to you from the classical literature.

> The czar himself is powerless against the bureaucratic body. He can send any one of them to Siberia, but he cannot govern without them or against their will. On every decree of his, they have a tacit veto by merely refraining from carrying it into effect.

I think that is a perfect description of problems Gorbachev faces, except that that was written in 1859 by John Stuart Mill, and it does indeed describe the problems that existed historically.

One of the dilemmas, then, and I will now go through them, as I say rather rapidly, that Gorbachev has to face: He has developed a large group of people that are interested in the reform, but the problem is they are mainly in the bureaucracy, the people, the "nomenklatura" as the Soviets call them. These are the people in effect who have to be fired or relocated. They are threatened.

ENTRENCHED BUREAUCRACY

What is Gorbachev's dilemma, dilemma number one? How can he build up support for the reforms when those who have the most to gain by improving the military, if you will, the bureaucracy if you will, are the ones who must be purged or must have some of their resources diverted? And the same thing holds for the workers. That is dilemma number one.

SUPPLY AND DEMAND

Dilemma number two: There is a dichotomy between supply and demand. That is one of the things that Soviet officials, Soviet economists, recognize and acknowledge readily. For that reason, they have a planning system. Everything is allocated or has been allocated to this point by the plan. Enterprises are assigned a specific target.

Now Gorbachev and his reformers are talking about doing away with the plan or reducing the plan in any case—not doing away with it, but reducing its magnitude—and allowing the market and wholesale operations to take over, in effect relying much more on the market and individual activity.

Gorbachev's dilemma: How can you switch this way without great distortions and bottlenecks? There are enormous shortages. Gorbachev recognizes that if he makes the switch, he is going to have even more shortages, more inflation, more distortions.

His problem is that he has to give money meaning. Money has no meaning right now. If you have money in the Soviet Union it does you no good. Today what you need in effect is ration allocation permits. You must phase out the rationing and bring in money. But how do you give money meaning without creating enormous inflation and, at the same time, unemployment?

Now, the corollary of that dilemma is that at the same time, if he is going to bring about change, Gorbachev has got to ensure that wage increases do not exceed productivity, which has been consistently the problem in the last decade or so. That means he has to cut wages. That means that he is going to affect the morale of the working force and the managerial force.

To improve quality, Gorbachev has instituted a nonmarket reform. He has instituted a reform called quality inspection. As a consequence of that, if you look at the production figures for this year, for the first time since Brezhnev's days, production is dropping in major industries—not steel—but major fabricated goods industries. In the case of Lithuania, for example, the production for the first half of the year is down in over one-quarter of the factories because the goods are being rejected.

Quality inspectors go in there, look around, and say this doesn't count; we only want to count "good" goods as part of the reform process. Junk no longer matters. What counts is quality. How is this handled in other societies with market mechanisms? They use bankruptcy. But Gorbachev does not have the time. Therefore, he sends out arbitrary inspectors to make these decisions.

His dilemma: How can he increase the quality and do it quickly enough to show the population, particularly the workers, that his system is working? He cannot get the workers to support him unless he can show that there are indeed changes that result from his reforms.

Things are worse now for many people than they were before. And I say the production reports, which we have not focused on too much in this country, for the first half of the year are quite serious in almost every industry which has value added attached to it.

PRICE REFORM

The third dilemma: To generate worker incentives, you need to bring about two important changes. You have to recognize that prices have to increase. He has to end the subsidy. Somebody asked the question earlier, what will the reforms cost? Right now, there are subsidies of 70 billion rubles, primarily on food goods. That comes to about $110 billion. They have to be eliminated.

The Soviets acknowledge that 13 percent of the factories in the Soviet Union are running unprofitably. If you are going to do away with those subsidies, that would mean you are going to have to have a threefold increase in the price of meat—you can imagine what that will do; a twentyfold to thirtyfold increase in the price of housing—you can imagine what that will do; and in addition there will also be unemployment as you close down those factories. That is politically explosive.

Gorbachev's dilemma: How can he stimulate new industry and better quality and flush out the old, eliminate it, unless he is going to have inflation and unemployment, and do that without political protest?

INCOME INEQUALITY

Gorbachev's dilemma number four: The Soviets have prided themselves on a certain amount of equality in their system. That is what communism is supposed to be about. However, inequality has been in existence for a long time because what counts in the Soviet Union is not money, but privilege, access to special stores. But for the most part, the Russians have had a certain amount of wage leveling.

Gorbachev now says that is bad. You should reward people if they work hard and let them do what they want. You should encourage indeed even private enterprise within certain circumscribed limits. But this is going to take away those privileges then from the party and make money the main force.

But if you have income inequality, that is going to cause tensions. We have already seen some tensions among the nationality groups. Even at this early stage the Soviets are having demonstrations in a way that remind me more of Cambridge then they remind me of Moscow, and the police can't quite figure out what to do.

As prices begin to rise and as incomes become differentiated, you are going to have even more tension, not only because indeed you have nationalities who are protesting and who are earning money in these circumstances, but because it is likely to be the minority nationalities that will take advantage of private trade, who will set up the private shops, not the Slavs. That is going to cause increased tensions and the Soviets don't quite know how to react to that.

There was a report that when they instituted a cooperative taxi operation, which was semiprivate, they closed it down because the taxi drivers started making too much money.

There is a cartoon that is in one of the current issues of the Soviet humor magazine Krodkodil. It shows two policemen at a collective farm market, which is normally the center of private trade, and they are looking at an old peasant who is engaged in weaving baskets. The police say to one another, "What should we do with this old man? Should we arrest him because he's making money privately, or should we reward him for showing initiative?" That is part of Gorbachev's dilemma.

So the fourth dilemma then is how can he encourage the "enrich yourself" mentality after so many years of attacking it? The police don't know what to do. And what will the ideological conservatives think about all this if he does indeed move in that direction.

WORKER ALIENATION

Dilemma number five: Gorbachev wants to heighten worker interest, to create a sense of participation, to end alienation—which is not supposed to happen—but now the Soviets are recognizing that it is happening in the Soviet Union. So he has ordered the election not only of managers of factories, but of foremen.

Gorbachev's dilemma: The foremen will have their own political mandate, even though they are supposed to subordinate to the managers. But if they are elected by the workers, will they take orders from managers? There may be such a thing as too much worker participation, and this is something that I think Gorbachev has not thought out carefully. No place else in the world has anything like that. I don't think it's viable.

JOINT VENTURES

Number six: Gorbachev wants joint ventures to facilitate the mastery of high technology, the introduction of high technology, but the bureaucrats are worried about this. So the order comes down: There will be joint ventures, and then the bureaucrats begin to sandbag it.

Why do they begin to sandbag it? Because they are worried about the ideological consequences. So far, there are only seven joint ventures that we are aware of. Almost none of them are in high technology, for a variety of reasons.

Gorbachev's dilemma: Can he bring about an infusion of technology through joint ventures without ideological backlash from the conservatives and from the bureaucrats who worry that some day Gorbachev may not be there to protect them. They worry they may have to answer to the fact that they allowed British, American, Japanese, Finnish businessmen to come in and exploit the Soviet people.

ENTERING THE WORLD ECONOMY

Number seven: The Soviet Union wants to become part of the world economy, to be competitive. To do this you have to allow enterprises to sign their own contract in foreign trade. Already 70 have been given that power at least on paper.

Gorbachev wants the ruble to be convertible, something that economists have a hard time conceiving. He wants to join GATT. He wants to join the IMF.

The Soviet Union, until now, has been the world's most protectionist society. You can imagine what will happen once you allow the infusion of new competitive goods. There will be massive unemployment.

Gorbachev's dilemma: If the Ministry of Foreign Trades monopoly is abolished, who will there be to prevent the accumulation of large foreign trade deficits. After 70 years of denial and the end of protectionism there will be massive imports. And who will be there to protect the factories from massive unemployment and bankruptcy?

MODIFYING CENTRAL CONTROL

Finally, number eight: Gorbachev wants to reduce Gosplan and the ministries' power, to end in a sense their control over production decisions. But the inputs are still determined by central government officials.

How can the enterprises do what they want to do when they are still constrained because the ministers still have powers, powers of promotion, powers of allocation? The minister can still pick up the telephone and say, Wouldn't it be nice if you would accommodate me on this, even though I know it's not in your economic interest. The phone call can still cause people to salute in the Soviet Union.

Gorbachev's dilemma: After 60 years of controlling from the center, will the enterprise manager really ignore the wishes of the center and the subtle hints?

OUTLOOK FOR REFORM

Let me conclude. Gorbachev's problem is that he is going too fast. He is stepping on everyone's toes. The reforms show no limit, no discrimination. Everybody is being affected, including the KGB and the military. In that regard, I would take issue with some of the things the previous speaker said.

But while he is going too fast, at the same time, ironically and tragically in some sense, he is not going fast enough. He is not going fast enough because he has to be able to perform to produce to show people that this is all working; indeed, sacrifice this way, because look at the rewards I have brought you. He has nothing comparable of the order of Deng Xiaoping to show that the reforms have succeeded. Deng Xiaoping has 80 percent of the population on his side, the peasants, because they have enriched themselves. So far in the Soviet Union, no one has enriched themselves; indeed, if anything, there is more confusion and, as the production figures show, production in many sectors is diminishing.

The transition involves the most complex, economic, and political issues that we know in academic or business or political life. And 70 years of central planning has given rise to hard economic challenges involving inflation and unemployment. Difficult as that may be, the political issues are even more complicated.

Will the population sit still for these incredible transformations when they have been guaranteed these 70 years, a social contract which says okay, we won't provide a high standard of living, and there may be a lot of government control, but offsetting that, there will be no unemployment and no inflation? Gorbachev himself says the next 2 to 3 years will be the hardest.

Let me end with a question that is being asked that I heard in eastern Europe. What is the difference between Dubcek of Czechoslovakia who introduced the reforms we know in 1968 and Gorbachev? The answer is none, but Gorbachev doesn't know it yet.

[The prepared statement of Mr. Goldman follows:]

PREPARED STATEMENT OF MARSHALL I. GOLDMAN

GORBACHEV AND PERESTROIKA

by

Marshall I. Goldman

Class of 1919 Professor of Economics, Wellesley College,
Associate Director, Russian Research Center,
Harvard University and the author of
Gorbachev's Challenge: Economic Reform
in the Age of High Technology

Gorbachev inherited an economy with a sagging rate of industrial and agricultural output. He discovered, however, that once the Soviet Union fell behind, there was no easy way to catch up. Gorbachev's first task was to restore confidence. For Gorbachev that meant sustaining the economic growth that Andropov had begun, but which began to lag under Chernenko. Gorbachev did that by stressing the need for improved worker discipline. That also meant a crackdown on alcoholism that went far beyond what Andropov had attempted. The sale of alcohol was banned before 2:00 p.m. and the number of liquor outlets was sharply curtailed. This had an immediate impact on industrial growth, which recovered rapidly from the decline that began in Brezhnev's latter years.

The emphasis on discipline and the crackdown on drinking was particularly important in increasing the production of petroleum. Petroleum output had begun to decline in late 1983. By 1985, petroleum production for the whole year was down 3%. In an effort to restore production, Gorbachev flew out to the main production fields in Western Siberia and insisted on better quality and less vodka. He followed up his visit with the wholesale firing of local Party and petroleum industry officials. The drop in petroleum output came to a halt and one year later, production was up rather than down by 3%.

The visit to Western Siberia involved more than just a crackdown. Gorbachev also sought to stress the positive. He embarked on visits throughout the country urging people everywhere to work harder warning them that if they did not do their best, the country would suffer. He became ubiquitous, appearing in remote regions which had never had a personal visit from a Soviet leader, or for that matter a Russian tsar.

But words and wishful thinking are not enough. Recognizing this, Gorbachev decided early on that he must take forceful, albeit counter-revolutionary action. Only by yanking the Soviet economic system by its roots, could Gorbachev hope to break the gridlock the Soviet economy has created for itself. Thus beginning in late 1986, he began sketching out a series of proposals for reform, which culminated in the more extensive program which he presented to a plenum of the Central Committee of the Communist Party in June 1987. Not all of his proposals mesh properly. Moreover, some of his ideas have met resistance and therefore have been delayed. For that reason the bulk of the ideas are not scheduled to be put into effect until 1991, the compromise date, and there is reason to question whether he will succeed even then. At the same time, he may well introduce some additional reforms. As of now, however, we have a reasonable idea of his overall scheme.

Gorbachev's main priority is to diminish the role of administrative decision making. That means sharply curtailing, but not eliminating the role of Gosplan and the ministries. To fill the vacuum, Gorbachev has sought to transfer to the periphery - that is to the enterprise itself. This decentralized decision making is to be guided by a more meaningful set of prices for raw materials, labor, and finished products. Unlike the past, when prices were based on a cost plus basis, prices in the future are also to reflect demand. Moreover, enterprises will have to learn how to worry about reducing costs. Unlike the past, when for all intents and purposes, there was no such thing as bankruptcy, henceforth Soviet enterprises must earn a profit. They are to be self financing - that is they must finance themselves with their own profits, depreciation, and if need be, repayable loans. They can no longer count on continuing subsidies from the state budget. Those enterprises that operate in the red will be declared bankrupt and closed down.

With time, enterprise managers will also be given more power to choose what they will produce. That may mean producing a different product mix than would have been prescribed by Gosplan. Since the enterprise will also have to worry about costs, that may also mean firing workers. Enterprises, particularly large ones, are to be given the power to enter foreign export and import markets directly. Some seventy enterprises have already the right (on paper at least) to import and export directly without involving themselves with the Ministry of Foreign Trade, which until recently had a monopoly on all foreign transactions.

The meaning and importance of the ruble will be further enhanced because factories which hold rubles will become entitled to buy supplies and machinery with those rubles. In the past, that was not the case. Heretofore the allocation of resources has been determined centrally - what counted was not how many rubles you had, but how many allocation or ration coupons you had been authorized by officials in Moscow. To make this shift to the ruble and away from ration allotments meaningful, wholesale warehouses will be established, which will sell production materials to ruble holders. They will be independent of the ministries. If successful, these warehouses should go a long way in eliminating both supply bottlenecks and hording.

In the same way, access to credit will be decentralized. Gosbank's monopoly will be abolished and several banks will be created to finance existing and new industrial undertakings. These banks, like the factories, will operate on a profit and loss basis. A tax will be set and anything earned above that becomes the property of the enterprise. The proceeds may then be used for wage bonuses, improved housing for the employees or purchases of additional plant and equipment.

Finally, to generate an even greater sense of loyalty and involvement in the workplace, managers and foremen are to be elected by secret ballots from among several candidates. In large factories, a labor collective may be elected from the ranks to make the actual decisions, but the members of the collective are also to be elected.

If implemented, these steps will mark a sharp change in the way Soviet enterprises have traditionally operated. Even more radical (if that word can be used in this context) is the decision to authorize private business and services, and joint ventures on Soviet territory with partners, not only from Eastern Europe, but the capitalist world. Admittedly, Soviet authorities have imposed strict limits on what these new private entrepreneurs can do and when. For example, they cannot hire any employees other than from within the family and unless they are pensioners or students, they can only operate their businesses after they have finished their regular state jobs. Joint ventures are to be similarly circumscribed. Foreigners may hold no more than 49% of the equity and both the president and chief operating officer must be Soviet citizens. Nor is it a selling point to potential investors in the West that the repatriation of profits outside the Soviet Union is discouraged. Yet neither private businesses nor joint ventures have been allowed since Lenin introduced the NEP (New Economic Policy) in the 1920's. Bat Gorbachev, unlike Lenin, has not rationalized these moves by calling them a step backwards in order to take two steps forward. Gorbachev evidently regards these measures entirely as a step forward.

Certainly Gorbachev has to be praised for the boldness and far-reaching nature of his reform proposals. If asked to serve as his economic consultant, I would have prescribed much the same medicine. However, what may make sense on paper is not always politically or practically acceptable.

Gorbachev's dilemma is that given his determination to succeed, he may have moved too fast, even though at the same time he may not have moved fast enough. That paradox is explained by the fact that his proposals are so far-reaching, that they threaten almost everyone in the society. As we have seen, that involves workers who will have to work harder or face pay cuts or even discharge, managers who may be voted out of a job, as well as ministers and bureaucrats whose offices may be closed down. Conceivably if Gorbachev had decided to approach his reform gradually, he might not have alienated so many people in the country at once.

At the same time, Gorbachev has not been able to move fast enough to demonstrate that all this experimentation and disruption is worth the effort. Both the statistics and on-site inspection and discussion with Soviet friends reveals little improvement beyond what normally takes place year to year. As B. N. Yeltsin, the head of the Moscow Party

Organization, and one of the most outspoken leaders of the Party acknowledged in March 1987, "Our people have not felt substantial changes." Gorbachev himself concedes this problem. In a speech just prior to the one made by Yeltsin, Gorbachev admitted that "everybody is calling for restructuring ... but what has it produced?" This is being asked not only by those opposed to restructuring, "but also by those who are for restructuring."

Unlike the Soviet people, we in the United States sometimes forget that Gorbachev is not the first reformer the Soviet Union has had. Admittedly Gorbachev is much more ambitious and is reaching much further than his predecessors have. But the complaint being heard in Moscow is that while the reformers always call on the workers to make the first sacrifice, in the past at least, the workers seldom received any benefit.

Yet if Gorbachev is to succeed, he must show and show quickly that his reforms have produced results, particularly an improvement in housing and the availability and distribution of consumer goods. If not, he will have no meaningful support base for his efforts.

But Gorbachev has a catch-22 problem. The workers will not work harder unless they see there are more abundant and more desirable goods to buy with the money they earn. But it is all but impossible to produce more and better goods without worker involvement. Yet the Soviet industrial infrastructure has deteriorated so, that even if the workers decided they wanted to work harder and better, they would still find themselves frustrated by the machinery they have to work with. For the most part, it is ill-designed, imprecise, and wasteful. Thus even with the best of intentions, it would be hard in two or three years time to produce goods that meet world standards.

The same barrier makes it impossible to improve in any meaningful way the distribution and sale of consumer goods. The Soviets have systematically deprived the consumer distribution network of adequate resources. There are simply not enough or adequate stores, warehouses, and other facilities. Even with world class management, these shortcomings cannot be remedied overnight or even in four or five years. The big unknown is whether Gorbachev has that long.

Because the nature of the changes he is seeking is so radical, it is not only that he has relatively little time to produce results; he also has to resolve a whole series of managerial dilemmas that would baffle even the most resourceful manager. Here are a few:

o Gorbachev has to stop the practice of increasing Soviet workers wages faster than productivity. But as he cuts wages, worker morale and product quality will decline. For example, as part of his effort to improve quality, Gorbachev sent state inspectors to fifteen hundred of the Soviet Union's largest factories. These inspectors were given the power to reject poor quality output. Once rejected, the goods produced were not included as part of plan fulfillment and therefore, bonuses were not paid so that salaries in some of the Soviet Union's largest factories fell 2-10% during the first quarter of 1987. Equally significant, Gorbachev ignored his own guidelines - less reliance on administrative dictate and more use of market forces. In Western economies, poor quality is usually flushed out of the market because no one buys the goods. But that is a risky and time consuming strategy in the Soviet Union, where goods have traditionally been in short supply. So Gorbachev acted like his predecessors - when in doubt send out the bureaucrats from Moscow - not a good example of what the reform is supposed to mean. Gorbachev's dilemma - how to improve quality and quickly, using market techniques?

- To provide incentive to factory managers as well as peasants and farm managers, Gorbachev's advisors, as well as Gorbachev himself, have been warning that prices will have to become more meaningful. But the implicit social contract in the Soviet Union provides that in exchange for relatively slow improvement in the standard of living and restricted personal prerogatives, there will be no explicit inflation or unemployment. But if Gorbachev is to eliminate what he says is a 70 billion ruble ($110 billion) annual subsidy on consumer goods, that will necessitate a 20- to 30-fold increase in housing costs and almost a 3-fold increase in meat prices. As the Polish leadership can affirm, such price hikes can be politically explosive. For that matter, the reason why meat prices in the Soviet Union have been unchanged since 1962 is that the price changes then ignited riots, necessitating a mobilization of Soviet troops which resulted in shootings and loss of life. An increase in unemployment will produce the same result. That is why Gorbachev has attacked those in and outside the Soviet Union who have warned that a meaningful reform will necessitate a minimum unemployment rate of 2.5 to 3.5%. Gorbachev's dilemma - how can he rid himself of unproductive worker's and products and at the same time stimulate productivity and the invention and production of new and more desirable goods unless he faces up squarely to price increases and unemployment, neither of which is likely to be accepted by the Soviet population without violent protest?

- The Soviet people have also accomodated themselves to the fact that income for most working people will be relatively equal. In the past, an exception was made for Party officials. It was not that Party officials incomes were so much higher than average, but that they had access to special shops and privileges. As often as not, high incomes were associated with illegal dealings in the second economy or the black market. Now Gorbachev wants to encourage initiative and reward it with higher incomes. But despite his best efforts, displays of wealth are regarded as indicative of unethical practices and invite police crackdowns. For example, the operation of a private taxi cooperative in Krasnoyarsk was ordered closed because the drivers were earning too much money. Gorbachev's dilemma - can he espouse an enrich yourself mentality after so many years of opposition to it? No wonder that of the twenty state taxi cab drivers I interviewed in Moscow and Leningrad in the summer of 1987, absolutely none thought that there would be more than a very few private cabs in their cities. Some insisted there would be none. How will ideological conservatives accomodate themselves to income differentiation, inflation and unemployment?

- To show that Soviet Union will have a more democratic economic system than any other country in the world, be it communist or capitalist, Gorbachev, as we saw, has called not only for the secret election of the factory managers, but also of shop foreman. But if they have their own political mandate, will the shop foreman respond to orders from the factory manager? Gorbachev's dilemma - how can he make the workers feel involved and stimulate a sense of partnership without destroying necessary managerial prerogatives?

- Gorbachev is hoping that the ideologically suspect joint ventures will facilitate the Soviet Union's mastery of high technology and an increase in its exports. But to avoid provoking Soviet conservatives more than they have been already, Gorbachev's subordinates are insisting on a host of cumbersome restrictions. These limitations, however, scare off foreign investors. At this writing, only seven joint ventures have been officially approved. Moreover, all of them are rather minor in scope and involve low, certainly not high technology. The most sophisticated is a factory producing commercial refrigeration units. More typical are the timber operations in Siberia, and a hotel and an Indian restaurant in Moscow. How can there be anything else as long as the foreign partner is unable to exercise quality control and to assure himself of profit repatriation? Gorbachev's dilemma - how can he obtain the infusion of technology he wants and needs without risking an ideological backlash?

- Recognizing that as long as Soviet industry is protected from foreign competition it cannot keep up with western technology, Gorbachev has decided to allow certain enterprises and ministries to ignore the Ministry of Foreign Trade and contract for their own imports and exports directly. He has also said the ruble should be convertible. While the Ministry of Foreign Trade's monopoly over all foreign trade has proven to be a stifling bottleneck, it has on the whole helped the Soviet Union to avoid large balance of trade deficits. Gorbachev's dilemma - if Soviet individuals and enterprises are allowed to import or export what they want freely, will the Soviet Union be able to avoid large trade deficits, especially given that in the first seventy years, imports from the outside world have been severely circumscribed?

o Finally, the keystone of Gorbachev's reforms is his call for a sharp contraction of Gosplan's and the ministries' powers. But as long as the factory manager is beholden to the ministey and Gosplan for production components and other inputs, the enterprise managers will find that they still lack the powers to determine their output mix. Admittedly most countries combine some degree of central guidance and influence with managerial independence. But a mix of central guidance and autonomy is much more difficult to promote when a society is attempting to move away from central planning than when it has never had it. As long as the authorities in Moscow have the ability to dispurse favors, even phone calls from Moscow will usually be treated with preference, regardless of what the market might dictate instead.

> Gorbachev's dilemma - can he reconstitute his managers so that after six decades of having learned how to respond to ministerial and other central wishes and commands, his managers will willingly ignore those wishes and the subtle hints of those at the center?

Gorbachev will have to make some tough choices in the months ahead. Like other managers around the world, he has discovered that upending a system that has resisted change for over sixty years is not easy. No matter what options he chooses, he undoubtedly will encounter domestic opposition. As he himself has put it, the far-reaching nature of his restructuring program has meant that there are many "who have had their toes stepped on" and who as a consequence are very much opposed to these reforms. Acknowledging that there may be more opponents than supporters of his reforms, Gorbachev has reiterated over and over again that "the next two to three years will be the most difficult." But given the magnitude of his task, the odds that he will succeed do not seem to be in him favor.

Representative SCHEUER. Very good. All right. Professor Murray Feshbach of Georgetown University.

STATEMENT OF MURRAY FESHBACH, RESEARCH PROFESSOR, GEORGETOWN UNIVERSITY

GORBACHEV'S PROGRAM

Mr. FESHBACH. Thank you very much. First, I would like to thank the Joint Economic Committee for its longstanding, in-depth interest in Soviet economic issues, be it in their publications or in hearings such as the current series; and second, of course, I thank you for inviting me to participate.

I have a short oral statement which is largely complementary to my written prepared statement.

Gorbachev was elected to power to succeed Chernenko early in 1985 with the apparent charge to do something about the domestic malaise which was undermining the power and the status of the Soviet Union. Since that time, he has initiated many far-reaching changes. While not all are fully or largely successful, not all will be implemented as enacted. But there has been a remarkable amount of change in the almost 2½ years since his assumption of office.

The degree of success and retention of power is still an open question, but the uncertainty seems to me at a much lower level than that expressed by some Western observers, nor is it quite as immutable as others have asserted.

Gorbachev will pursue those policies which are necessary for him to carry out his role, not those which outside observers deem necessary to be on his agenda. This in turn is crucial to our bilateral relations with the Soviet Union, not only on the near term but also in arms control negotiations which can affect the longer term world situation.

COMPONENTS OF REFORM

Gorbachev has confronted the situation, it appears to me, in three steps or phases. First, it was to establish the need for perestroika. He has spoken in crisis-like terms, terms stronger than many of us in the West have used, to describe the Soviet domestic scene. This was his device, I believe, to establish the need to pursue that agenda which he himself described at party plenums and certainly at the party congress in early 1986.

In the second phase, he is attempting to implement his strategy of new thinking in foreign as well as domestic policy by elevating his supporters to positions of power, by enactment of appropriate legislation, and by changing the work ethic psychology of the population.

Lastly, in the third phase of radical reform period, running up to the next party congress, to be held early in 1991, he will test out these policies, attempt to reinforce his power base, and keep the momentum of the basic changes he has already inaugurated.

OUTLOOK

To say that he cannot make progress, achieve much, is more than premature evaluation in my opinion. Far from easy, he certainly will not see this entire program adopted or be fully successful. Nonetheless, I believe that he will remain in office if only because the alternative is a choice that is not viable for the power brokers of the Soviet system.

While I believe that he will only partially succeed in his entire array of promises and programs, the need is eminent for the changes and improvements which he has clearly enunciated before and after assuming his current position.

The Politboro undoubtedly gave tacit if not explicit agreement to his program. That it will not be easy, that there is opposition, is abundantly expectable, documented and certainly again repeated by Marshal Goldman just a moment ago. But I doubt it is as powerful as claimed by many observers. The exigencies of the economic, scientific, and technological, as well as political and military requirements of the Soviet Union are such that Gorbachev will likely continue in office almost regardless of the logic of any counterargument.

With proper caution that Gorbachev's frequent declaration or analogous expressions in other Soviet leading commentators' speeches that there is a crisis is a useful tool for getting a legislative program addressed and enacted, undoubtedly the Soviet situation is such that they must pause for rebuilding, regenerating and restructuring to meet the needs of their superpower status.

MANDATE

Gorbachev must have been given a mandate to do so when he, rather than Romanov, Grishin, or any other putative candidate was selected as General Secretary in the early spring of 1985. Very shortly thereafter, at the April 1985 party plenum, he provided the basic outlines of his program. Given his extremely short tenure in office at that time, it is understandable that his action program was not fully, explicitly and precisely developed by that date.

Nonetheless, the range of activities, the changes and the achievements by now are much more than almost anyone predicted some 2 years ago. A much clearer outline was presented in the September 1986 publication of a program of 38 legislative acts to be prepared by various agencies before the end of the Five Year Plan period; that is, by the end of 1990.

This list was the harbinger of all 11 core economic items announced at the June 1986 party plenum on prices, investment, organization, et cetera, at which Aganbegyan, Gorbachev's principal economic adviser, stated that they had been adopted and shortly would be published.

OBSTACLES TO REFORM

How they will be implemented, given the considerable opposition, however, is too early to determine. That there is considerable resistance and recalcitrance should not be surprising, given the new imperatives, breadth and impact of Gorbachev's program.

Confusion and resistance is undoubtedly there in the writings of individuals and institutional representatives, speeches and behaviors of some members of the political, economic and military leadership, and just sheer overload of the bureaucracy, as well as those managers and workers who supposedly should no longer pretend to work if they bear responsibility and wish to get paid according to the new rule, but must work.

If it is correct that Gorbachev's future is very cloudy, this also brings into question the likelihood of continued participation and adherence to arms control negotiations. At present it appears that the Soviet military is willing to, or is required to participate in this military political arena.

PAUSE IN MILITARY EXPENDITURES

Perhaps the key public statement that a pause, but not necessarily a reduction, in military expenditures, however, was agreed to by the military came at the time of the 27th party congress in February–March 1986. The then Minister of Defense, Marshall Sokolov, noted that there were complicated issues confronting the Soviet Union and that resolution of "domestic as well as foreign policy, national-economic, as well as defense tasks is necessary."

As such, the sequence and priority listing enunciated by Sokolov must have reflected a compromise between the military and the politicians that economic and societal issues would have to be resolved first in order to make them stronger later. An alternative way of looking at this issue: a caution just to be aware that we do not know yet if there was or is a change in the long-term foreign and military policies of the Soviet Union.

Presumably this message of the need to develop and strengthen the economy and society initially was the thrust of the still unpublished speech of Gorbachev to the military command at a meeting held in Minsk in June 1985, some 6 months earlier than Sokolov's statement to the party congress.

NEED FOR REFORM

Before and during the same party congress, Gorbachev virtually stipulated that if the Soviet Union does not achieve the goals of the accelerated scientific and technological progress outlined in the party documents, that it cannot maintain its position as a superpower.

In order to achieve this, the emerging new technologies in computers, robotics, biotechnology, new materials, electronics and others, which have a military as well as civilian dimension, have to be developed, assimilated, and disseminated.

As part of this development, the productivity of the labor force as well as capital productivity would have to be increased dramatically. To do this in turn, he needs consumer goods; he needs better relations with the population, more reality than promise to avoid a continual growth in cynicism among the young, and so on and so forth.

The point here is that the problem is multidimensional, difficult, and undoubtedly meeting with much resistance by individuals who do not want to change their old habits and work patterns. Nevertheless, I believe that his mandate is such that he has been given a longer rather than shorter period of time to test out his programs. Whether it is several years or the 10–15 years stipulated by Aganbegyan as well as Zaslavskaya to truly find out if the program will work has certainly not been determined yet.

OUTLOOK

However, having addressed all these issues does not necessarily mean that the Scylla of needs can be met by the Charybdis of scarce resources. Competing demands for these scarce resources means that he will have to convince the military to be patient still and that the national security of the state can be preserved even with arms control agreements, or perhaps because of them.

The population will need to await the future when all of his promises about housing, food, energy, incentives, health services, et cetera, will be met and the political leadership not to be fearful that the party's control is threatened.

He has by this time, and will undoubtedly in the future, make many promises to many people. I do not expect that he will meet all of them, but he likely will succeed to some degree in each of the programs. Precise numbers or proportions are not important. The point again is that he will make progress, but will it be sufficient for the other power sharers of the Kremlin? I may believe so, because the alternatives also must be considered, and they likely are perceived by them as less likely to resolve the major problems of the Soviet Union. Thank you.

[The prepared statement of Mr. Feshbach follows:]

PREPARED STATEMENT OF MURRAY FESHBACH

I. CRISIS CALL BY GORBACHEV

In March 1985 Mikhail Gorbachev became General Secretary. Since that time the Soviet Union has undergone a tremendous amount of change, or at least there has been a tremendous amount of talk about change. Key areas of the Soviet economic and social structure have been designated as prime targets for the perestroyka or rebuilding, program inside the Soviet Union.

There has not been any shortage of areas categorized as being subject to need for reform in the restructuring process. In general, economic reforms and administrative reforms have led the way, with social reform closely following if not fully integrated into the economic reform. Within these areas there has been fairly detailed criticism of specific aspects of each.

Certainly, economic reforms have taken a leading role. In Gorbachev's June 1986 Plenum Report he speaks repeatedly of the need to achieve dynamic rates of economic development. The whole new Five Year Plan is built on the foundation of a radical improvement of the production efficiency figures through accelerated scientific and technical progress. And scientific and technological progress is needed if the military is to be provided with the latest achievements in science and technology. Part of the goals for this area are to be achieved through international trade, through integration into the international economy. Thus, the innovations in foreign trade organization, laws on joint ventures, and the long-term goal of joining the General Agreement on Trade and Tariffs (GATT) and the International Monetary Fund (IMF) can be readily considered concomitants of the drive for domestic dynamic efficiency.

The problem of 'over-management' is a recurring theme, especially in the republics, and especially the petty tutelage of individual enterprises by local party organs as well as governmental agencies. The tendency in the past has been to create new and more management bodies instead of making current ones more efficient. According to Gorbachev,

> The time that has elapsed since the Congress [of the Party in February-March 1986] has shown that the pace of our advance and of the mastering of new methods of economic management is slowed down considerably by the unwieldy nature and inefficient work of the management apparatus. The process of the redistribution of rights and duties among central economic departments and ministries on the one hand and enterprises, production associations and work collectives on the other is progressing very painfully.[1]

At a Conference in June 1987, held at the Central Committee of the Communist Party of the Soviet Union, the question under discussion was that of radical restructuring of the management of the economy. It was decided that the activity of the ministries was

> inefficient in scientific and technical progress which has led to the fact that the scientific and technical standard of a number of sectors lags significantly behind the best world standard.... For the radical improvement of the activity of ministries it is proposed that they be relieved of the function of operational management of enterprises and that the fallacious practice of redistributing assets from highly efficient enterprises to inefficient and loss-making ones be terminated.[2]

One month later, in July of 1986, Pravda Editor-in-chief Viktor Afanasyev railed against the bureaucratic ineptitude and stone-walling that goes on:

> Initiative is coming up against the stone wall of indifference and sometimes against that of open resistance.... At times, the most wonderful decisions, the most wonderful resolutions come up against a whole series of instructions, recommendations, rules, regulations and restrictions; there is a kind of bureaucratic stratum, if you will, of officials, of apparatus-workers, who consider it to be their duty, so to speak, to transpose these party resolutions into their own officialese or bureaucratic language.[3]

As noted previously, science and technology are an important aspect to the economic reforms. Gorbachev roundly criticised the current state of affairs also in his June 1986 Plenum speech:

> The existing orientation to the average or even low technological level of products was to a certain extent legalised by the standards which were in effect. The system of standards did not mobilise designers for a quest for new ideas and did not raise a barrier in the way of backward machines and equipment. Evidently, a kind of inferiority syndrome that emerged at many research institutes and design offices also played its role. They tried to justify the low results of their work by claiming that it was impossible to work better.[4]

One year later, at the June 1987 Party Plenum concerned with economic restructuring, B. I. Fomin, General Director of the Leningrad Elektrosila Association, stated that a great number of organizations, scientific research institutes, and design bureaus have grown up in the country which are essentially not doing their job. He then proposed that they be subjected to a certification procedure.[5]

Various specific ministries were castigated specifically by

Gorbachev in 1986. This requires "thorough streamlining of the entire construction industry [which] will have to be undertaken and advanced experience will have to be more widely used."[6] And Gorbachev specifically points to the Ministries of Automotive Industry, Heavy Machine-Building, Coal Industry, Power and Electrification and Light Industry for systematically failing to save resources.

The machine-building sector, which has received a major investment push as the lynchpin toward further and rapid economic devlopment, came under heavy criticism especially for its current low technological level of machines and equipment. The planning of machinery and equipment production in tons was denounced as an unacceptable practice and "serious errors in the policy of capital investments" need to be rectified immediately:

> ...the shortcomings in investment policy had the most adverse effect on the development and the technical level of the engineering industries...The prestige of engineering creativity was undermined, and the once flourishing national schools of technology designers withered away.[7]

Social issues which have come under scrutiny abound. Housing construction is of course a major theme: "Special attention is given to the housing construction programme," said Gorbachev in his June 1986 Plenum report. "Housing construction in the countryside will receive preferential development."[8] And again a year later: "The question of housing construction has now been elevated to the first place everywhere and is posed more keenly than the food problem and other questions."[9]

The education reform is a whole area of consideration unto itself, but is very much tied to Gorbachev's push for improved science and technology in industry and labor utilization. Health reform is the subject of the draft of a major new decree issued in the main newspapers of August 15, 1987. They can also be thought of as facets of the understanding that the "human factor" is much more complex than viewed previously. Thus, when Gorbachev first took over, the initial thrust was directed against poor work discipline and alcohol abuse. Later, through the efforts of Tatyana Zaslavskaya, of whom more later, the human factor became a much broader field of consideration. Thus, housing, consumer goods and services, education and health issues are clearly related to a wider concept of the needs of a much different labor force than that available at the time of the formation of the planning system in the late 1920s and early 1930s.

The issue of quality control is also a leading topic. Gorbachev singles out the "notorious gross value of output (val)" measure of industrial activity:

> Assignments in terms of gross indices of various form play a major role in assessing the performance of industries, regions and enterprises. Since this is so, costly materials are often used for the sake of increasing this 'gross'value.... We are fighting for efficiency, but look at the really stupid situation in which economic managers find themselves: They manufacture a cheap product and get a dressing down for failing to meet the target assignment in terms of rubles, they introduce a new product, save resources and again it turns out that they have placed their enterprises and sometimes even the whole industry in a tight spot.[10]

It is precisely this kind of problem that led the Politburo and the Council of Ministers to pass a special resolution on a State Acceptance Commission system of state-controlled independent product quality approval with the thought in mind that "measures of a technical and economic character, standardisation and certification of products, price-setting and the system of moral and material encouragement are directed toward improving the quality of output." [11]

The need of reform in the system of pricing has been called for to help utilize materials more efficiently. Distorted or exaggerated prices based on the input approach are often used to conceal shortcomings in technology, says Gorbachev, as well as creating an atmosphere in which resources are inefficiently used. At the restructuring conference in June of this year, it was asserted that

> the existing prices encourage the inefficient use of resources. For fuel and raw materials [prices] are between 1.5 and 3 times smaller than world prices. On the other hand, prices for foodstuffs are on average half as much as the costs of their production. There is no direct link between the lowering of expenditures, the efficiency of economic activity, and the material reward of the labor collective.[12]

and also

> It is envisaged that the practice of price formation will be radically altered and that these prices will consistently reflect socially necessary expenditures, and their stimulating influence on accelerating scientific and technical progress.[13]

Having recognized the problem, however, is not yet the prescription nor the solution, but is a major step in contrast to the past ostrich-like approach.

Social issues which have been of concern to Gorbachev and the Party leadership include questions of health care, alcoholism, the environment, and demographic trends. Much has been written about the anti-alcoholism campaign and the current controversy over the state of the health delivery system. Soviet analysts generally had put aside these issues and covered themselves with platitudes about progress in these areas. For example, it is only since Gorbachev's accession, and the recent ouster of the top leadership of the health establishment in the Soviet Union, has direct, serious consideration been given to the health problems of the Soviet economy, society and military.[14]

In the context of publication of the Public Discussion Law, Gromyko brought up several pressing problems.

> The urgent tasks of our social policy include: solving the food problem, building housing, schools, hospitals and children's institutions, improving the quality and diversity of goods and services, strengthening people's health and providing all the necessary conditions for their recreational and leisure-time activities, protecting the environment and many other questions.[15]

Gromyko then went on in considerable detail on the problem of environmental protection. He mentioned the problem of water resources, air pollution, especially in industrial areas, and how that could affect the health of the population. Gromyko also expressed the opinion that "our laws should facilitate the affirmation of a healthy way of life. This presupposes the continuation of an uncompromising struggle against such grave ills as drunkenness and alcoholism."[16]

Gorbachev emphasized his desire that there be an effort to ensure that a healthy approach to life gain ground. "I would say in this context that the struggle against drunkenness and alcoholism remains among our most urgent tasks. We should take guidance in this struggle from the opinion of our people rather than from those who are addicted to alcohol."[17]

Part of the issue of health care has to do with the publication and/or accuracy of statistics. "Figure-padding" apparently is a common practice in many areas of the Soviet social and economic system and is a problem which Gorbachev wishes to be rid of in part so that the true dimension of the problems which they are addressing can be accurately assessed. In the context of industrial corruption he uses the example of a regional party first secretary who

> held a negative view of criticism, sheltered 'convenient' people and tried to conceal failures and, in order to color the real state of affairs, quite often induced economic managers to resort to report-padding and had little concern for the development of the initiative of the party organizations or for the work and social activity of the people...."[18]

A final area of reform, which can only be mentioned here, is in the Agricultural Sector. Again, much that needs to be done is linked to such sectors as the machine-building industry, transportation, and, of course, the housing and consumer services available to rural workers.

II. PERESTROYKA INITIATION

Once the cri de crise has been heard and the atmosphere for significant change been established, then the beginning of structural changes can be initiated. And this is where they are now, not at the concluding phase, but only the beginning of the second phase. As past unsuccessful attempts at reform have shown, the task is enormous.

Many of the items currently under scrutiny also have been scrutinized at some point in the past. They were the subject of heated debate over how they should be restructured. Certainly this is not the first economic restructuring through which the Soviet Union has passed. One might say that the Soviet Union was founded on an economic restructuring of the tsarist system and that the Soviet leaders have been "tinkering" with the system ever since. After the period of war communism, NEP can justifiably be called the first economic restructuring of the Soviet system soon after the Revolution. But innovation soon fell to the dogmatists (i.e., Stalin). The Soviet economy geared itself toward rapid industrialization with minimal emphasis on the consumer sector or on quality. Quantity at any cost was the preferred option.

The next serious effort at economic restructuring came under Khrushchev. More emphasis was given to the consumer sector, including housing. But changes were instituted too precipitously, too unilaterally, and too "free" for the Party-liners, Khrushchev was ousted in 1964, and the economy settled back into its past mode of operation, i.e., the emphasis centered on quantity rather than quality, extensive growth rather than intensive growth. There was a brief flurry of activity with the Liberman proposals to make profitability, i.e., the rate of profits (determined as the ratio of profits earned to the sum of working and basic capital, and definitely not profits in the western sense), the principle measure of economic performance. But its demise occurred soon after. One can think of this, as well as the current drive for efficiency as a desire to have the benefits of a capitalistic mode of production in a non-capitalist form of economic organization.

The current social reforms echo prior attempts at reform as well. The current education reform in many ways parallels the 1958 reform, with a reorganization of the educational establishment and emphasis on work training and experience. By 1962 it was clear that it (the 1958 reform) was a failure, and in 1965 it ended. The housing problem has been a recurrent theme ever since the foundation of the Soviet state, as has the problem of availability and quality of consumer goods and service.

Earlier efforts to stem the flow of alcohol throughout the country were unsuccessful, but the current anti-alcohol campaign is much more serious albeit unable to prevent production of moonshine/home brew and a recurrence of recidivism among alcoholics. If it continues to gain, the economic reform with its high dependence on the growth of productivity may well be negatively affected by the lower working capacity of unhealthy workers who may not drink on the job as before, but are suffering from illnesses related to their alcohol abuse.

Nor is agriculture reform anything new. Agriculture was "revised" under collectivization in the 1920s and 1930s. Khrushchev initiated the Virgin Lands program and split the party into industrial and agricultural components. The Non-Black Earth Zone development is yet another attempt at increasing agricultural output. Most recently, a structural reorganization was instituted and a superministry-equivalent --the Gosagroprom-- agency was formed. Early signs point to a potential success in this important area.

Of course there are also areas which traditionally have not been the subject of discussion, subject to much less reform and virtually subject to censorship and they have continued largely to be "non-topics". These include the military-industrial complex, the primacy of the Party in all affairs of state, and a more realistic picture of relationships among the various national groups to each other but primarily to the Russians. Only the latter subject is beginning to be more openly and critically discussed, especially since the events in Alma-Ata after the ouster of the former Kazakh First Secretary, Kunayev.

Why then was Gorbachev chosen to be the General Secretary upon the death of Andropov? Why should his attempts at reform be any different or potentially more successful than those of his predecessors? First and foremost, it must be emphasized that Gorbachev is ineluctably a "party man." He fully intends to keep the Party firmly entrenched in its leading role within the Soviet system. This point was clearly enunciated at the January 1987 Party Plenum. As a subsidiary point of his firm attachment to the primacy of the Communist Party, he is not going to attempt to turn the Soviet Union into a market economy. Whether a market socialist economy a la Hungary will be attempted remains a debatable issue. Many analysts have referred to him as a "technocrat", that is, one who is guided by practical thinking more than by simply party doctrine, or political loyalties (although, most assuredly, Gorbachev could not have reached the point he has without the sponsorship of others). In fact, it could be argued that the current support for Gorbachev is based more on individual loyalties than on the overall support of any given institution as a whole, which may be to his disadvantage in the long run, unless he can garner more support at the middle/apparatchik level.

But the Soviet situation--economic, military, social and scientific/technological is such that they must pause for rebuilding, regenerating and restructuring to meet the needs of their superpower status. A pause in foreign and military outreach--without neglecting of any targets of opportunity that they could avail themselves of without heavy cost--in order to regenerate the domestic economy and society is the basic framework for current and near-term Soviet policy. I believe that Gorbachev was given such a mandate. He, rather than Romanov or Grishin, was chosen in the spring of 1985 by the Politburo, the two putative competitors for the lead position.

Very shortly thereafter, at the April 1985 Party Plenum, Gorbachev provided the basic outlines of his program. Undoubtedly, the program policy outlined at this Plenum was neither fully nor explicitly given; it was clearly far from precisely worked out at that date. It has become abundantly clear that they (that is, he and his advisors) did not have a precise schedule for individual laws or regulations to be enacted; only that action was necessary to completely turn around a deteriorating situation. Nonetheless, the range of activities and the achievements to date are much more than almost anyone predicted some 2 years ago when he assumed office.

The atmosphere within the governing bodies for at least several years prior to Gorbachev's selection was that the economy needed revamping and that the "tinkering" of the past few years was not sufficient to really turn the Soviet economy around and get it back on its feet. According to Valentin Falin, head of the Soviet news agency Novosti, in an interview on June 19, 1987, in reference to why Gorbachev was selected:

> I would say that some of them [i.e., the Politburo] formed an idea of what personality the new general secretary was. For others it is still more or less unclear. They preferred the man because he has the right experiences, because he is relatively young, and because he had repeatedly proven that power did not go to his head. Whoever was in a position to observe Gorbachev closely before he was elected general secretary was convinced that the country and the party could expect a lot of this man.[19]

Moreover, Gorbachev's relative youth at the time of his election would seem to indicate that the consensus within the Party was that there was the need for an infusion of new ideas into the economy and the desire for continuity. Gorbachev would be around for some time and could see the changes through completion that needed to be made. Evidence of Gorbachev's relative popularity is exhibited by the short time it took for the top leadership to "rally around" Gorbachev and give him, if not wholehearted support, at least room to maneuver and to prove the worth of his programs. How long this period of "wait and see" will last is of crucial importance to his tenure in office. I believe it is longer than other western analysts, but not unlimited also. The Party Congress scheduled for early 1991 could well be a benchmark date for his evaluation report. At the same time, I also believe that he will remain in office for much longer than that point in time.

This is not to say by any means that Gorbachev has met with no resistance, open or otherwise. Even if the majority of the top leadership is willing to give Gorbachev at least verbal support, the vast middle echelon of the apparat who have carved out a niche for themselves may not be at all willing to cooperate in the troubled waters of the reform process. Inefficiency and the bureaucratic burden weighing down the Soviet economy have been a constant area of contention. The front-page editorial of Pravda on 12 April 1987 complained of the apathy, bureaucratism, and inertia from both Soviet officials and from the general population, undoubtedly also including the personnel of ministerial and subsidiary intermediate-level agencies above the enterprises themselves who would be subject to significant reductions-in-force as well as changes in responsiblity under the reform.

The "wait-and-see" attitude of the general populous is in many respects more of a threat to the success of Gorbachev's program than are the reservations held by the hard-line conservatives in the Party. Falin offers a description of three types who offer resistance to reforms:

> First, there are people who in the past have too often been disappointed... These people wonder if the leaders will succeed this time; let us wait and see. Should it really get better, we will follow later and adjust... There is another group. That group proceeds from the assumption that actually things were not that bad in the past. On the contrary, the economic problems were even rather profitable for them... They probably hold modest posts in ministries... Sometimes those people even try to make believe they support restructuring... However, deep down they are quite different... Finally, the third category includes those who ought to be criticized as

> dogmatists. They consider themselves the guardians of the ultra-orthodox revolutionary idea... Those people on principle cannot get reform into their heads.[20]

Clearly, the importance of the psychological atmosphere cannot be over-emphasised in regards to the population's willingness to accept change. In an interview on Hungarian television, on June 28, 1987, Nikolay Shishlin, Deputy Chief of the Propaganda Department of the Central Committee of the CPSU, stated that, "if we measure results so far against the expectations and hopes which people attach to restructuring, then we have to say that for the time being we have realized few hopes." He goes on to state, however, that "if we look at how little time has elapsed so far under the aegis of *perestroyka*, then we can say that we have done a great deal already."[21] That is, it is a matter of perspective.

Tatyana Zaslavskaya, the renowned sociologist/economist from Novosibirsk, and one of the leading advocates of reform, in a discussion held very recently (on 31 August 1987) at the American Enterprise Institute here in Washington, also underscored the importance of the psychological factor. In fact, it would appear that the importance of this factor if far greater than anticipated by the reformers. An intensive propaganda/information program for convincing workers and farmers, as well as the government bureaucrats, undoubtedly will be unveiled in the near future. Moreover, it appears that Zaslavskaya considers it necessary to wait for 10 to 15 years of reform effort before final evaluation can be made of its efficacy. Thus, it is much too premature at this time to make a final evaluation of reform's success or failure.

But there is also some part of the population that simply is not willing to be part of the restructuring. They, in fact, actively hinder its progress. Viktor Afanasyev, Editor-in-Chief of Pravda, expresses it thus:

> These people must go. And they are going, they will go, they are still going to go.... Yes, there are still people who hinder our development with mismanagement and indiscipline, who hinder it by divorcing words from deeds.... If you look the truth in the eye, all these are different forms of deception....[22]

Zaslavskaya, is not only a major advocate of Gorbachev's reforms, but is also Head of the Department of Social Problems of Labor and Social Planning of Labour Resources at the Novosibirsk Institute of Economics and Organization of Industrial Production. She repeatedly emphasizes the "human factor" as playing the decisive role in any qualitative leap in development. She emphasises the need for social self-awareness in every citizen as the main condition for victory of the restructuring process:

> Social self-awareness is the ability, the potential, the capacity of a person, group, or society to perceive the flow of social life as the clash and struggle between social interests. Between the interests of groups and strata which have different positions in society and are in complex relationships and interaction with each other.[23]

As part of the restructuring process, the widening of the enterprises' independent rights is achieved through reducing the authority of the management staff. Thus, the situation of this so-called intermediate stratum will likely change considerably under a full reform and it is here that most resistance will be met. Any economic reform is bound to come up against the conflict between the policy-makers and central planners, on the one hand, and the local enterprise managers and the "middle men", on the other. And, as Zaslavskaya points out, "economic reform presupposes a radical decrease in the state apparatus."[24] If someone's job is abolished and he or she is 50-55 years of age or older, it is only natural that they will oppose such a reform. And those who stay will require additional professional training or retraining which is a difficult adjustment to make. Falin, commenting on how the leading members of the general staff are coping with the concept of "new thinking" states that, "they should be able to cope with it... Reeducation is by no means easy, often less so for older people... Not everyone will be up to it. Some people will probably prefer to exchange an active role for a... supporting role."[25]

Zaslavskaya clearly has chosen or been chosen to take an active role in the push for restructuring. Abel Aganbegyan, Scientific Secretary of the Economics Department of the Academy of Sciences of the USSR (and former head of the Institute in which Zaslavskaya is employed) and Gorbachev's chief economics advisor, likewise has been out rallying support for Gorbachev's restructuring program. He sees resistance to the reforms existing at nearly every level: in the party, the council of ministe organs of economic management such as the State Planning Committee, the Ministry of Finance, the State Material-Technical Supply system, the banks, the all-union industrial associations, and so forth. It is because the spheres of authority are being divided up anew that those who are losing some of their power resist the changes.

The main area for radical reform, according to Aganbegyan, is in management. The existing system of economic management emerged at a time when, to a large extent, Soviet economic growth proceeded on the basis of exploiting additional resources. With the current situation of scarcer resources of capital and labor, the emphasis on scientific and technological development as well as the recognition of the importance of social requirements, there is a need for the democratization of management and of considering the "human factor" in the system of management. It is precisely this new approach which allows for and even to some extent welcomes criticism and public discussion, but which probably engenders some animosity in the process.

Igor Ligachev, the number two person in the Party, although favoring modernization of the economy, seems to hold a fairly conservative and cautious view of how to approach the restructuring process and goals. He is no stranger to the opinions of Zaslavskaya and Aganbegyan, having been party secretary for the Novosibirsk area in the early 1960s. But whereas Gorbachev has been calling for change through mobilization of the population, using glasnost' as a primary means of accomplishing this end, and democratization of the political and economic mechanisms, Ligachev has particularly stressed tighter labor discipline and change accomplished by administrative fiat, so to speak, from the top. Thus, even supporters of the reform differ on the actual procedure for its implementation.

Military and political issues are integrally linked to the economic and social reform program. At the 27th Party Congress, the then Minister of Defense, Marshal Sokolov, noted that there were complicated issues confronting the Soviet Union, and that resolution of domestic as well as foreign policy, national economic as well as defense tasks is necessary.[26] As such, the priority listing given by Sokolov must have reflected a compromise between the military and the power brokers that the economy and domestic issues would have to be resolved first, in order to make them stronger later. This is the political affirmation (at the Party Congress) of the "pause" noted earlier.

Presumably this longer term strategy regarding economic and social development was the thrust of the still unpublished speech by Gorbachev in Minsk in June 1985 to the military high command. Only afterwards can the military acquire the high technology in appropriate numbers, state of the art, and in required numbers can be delivered by a strong economy. At the same Party Congress (of February- March 1986) when Sokolov spoke, Gorbachev virtually asserted that if the Soviet Union does not achieve the accelerated scientific and technological progress anticipated in the plan--and derived principally from the investment push in the machine-building sector--then the country cannot maintain its position as a superpower.[27] To do this, then, the emerging new technologies in computers, robotics, biotechnology, new materials, nuclear engineering, etc., which have both a civilian as well as military dimension, must be discovered, developed, assimilated and disseminated. In order to do this, the productivity of the labor force (as well as capital) would have to be increased dramatically. And to do this, he needs consumer goods, better relations with the population, more reality than promise to avoid a continual growth in cynicism especially among the young, and so on and so forth. The problem is multidimensional, difficult and undoubtedly meeting with much resistance to change.

But I believe that this complexity has in part, if not in full degree, been anticipated. Whether it is through an advisory council on economic, or one on foreign policy per se, or arms control, or other issues, the dynamism of Soviet policy under Gorbachev is fascinating to observe, to confront, and contradicts all the old shibboleths about its lack of change--the muddle-through syndrome--as interpreted by many western observers. Having said this, however, does not mean that the Gorbachev "revolution" is fully ensconsed and irreversible as some Soviet commentators have asserted. There are still many questions about whether he will succeed in all his initiatives be they political, economic, military or scientific.

For example, while he has not yet placed Boris Yel'tsin, the Moscow City Party Chief, on the Politburo, nonetheless, the composition of the Politburo has been changed so much that he has appointed 8 of the 13 full members other than himself. In June 1987, three new appointees had been approved and even if not all three are fully beholden to him, at least the fact of movement is preserved. And movement there is. Witness also that he failed to get full recognition at the January 1987 Party Plenum of his proposed Party Conference for next year (1988). However, the June 1987 Party Plenum resolved the issue by setting the date of June 28, 1988, for a Party Conference--the first since 1941. Just as he did not succeed in getting his views fully or too rapidly addressed at the January 1987 Plenum, the Plenum also did not hear (nor release for publication, as of September 1, 1987), the speeches for and against him among the approximately 30 speakers and the 40 others who were scheduled but not "allowed" to speak (or time ran short--information is not available to know precisely). This may be a limit on glasnost'.

More intriging is Gorbachev's inability to divest himself of the allegedly non-cooperative heads of the State material-technical supply system (Voronin of Gossnab) and the State Planning Committee (Talyzin of Gosplan), both his appointees. Until the June 1987 Plenum, he had only denounced the policies and lack of enthusiasm in these key staff organizations for the new approaches he was advocating. This is the first time (in June 1987) that they have been named; and in all past cases, when the name of the recalcitrant has been announced, his tenure is significantly foreshortened thereafter.

The economics program was significantly advanced at the June 1987 Party Plenum. Undoubtedly it has led to confusion if not to opposition. Aganbegyan told a press conference at the time of the 27th Party Congress, a year and a half earlier, that it would take 2 to 3 years to work out a fully developed agenda and content of such an agenda of economic policies. A legislative program for the period 1986 to 1990 was published in September of 1986.[28] In the summary of the Thursday weekly meeting of the Politburo held on July 16, 1987, approbation was given to a set of legislative decrees to improve the economic mechanism of the country.[29] Soon thereafter, Aganbegyan revealed to the Moscow-based correspondent of *The Wall Street Journal*, that 11 decrees had been approved and that "it paves the way for an unprecedented transformation of Soviet society." These measures would "free many prices from central control, introduce wholesale trade,...institute a network of banks,...."[30] Undoubtedly these were the draft decrees hinted at by Gorbachev at the June 1987 Plenum. *Pravda* reported that they were designed to reorganize and redirect the activities of Gosplan, the Ministry of Finance, the State Committee on Prices, the State Committee on Labor and Social Questions, and Aganbegyan added, the State Committee on

Statistics, the State Committee on Science and Technology, State Material-Technical Supply agency, branch ministries, regional organs, and the Council of Ministers. So far we have not seen any of the 600,000 copies promised by Aganbegyan. According to The New York Times, Zaslavskaya told an interviewer (as she also told those of us attending the discussion at the American Enterprise Institute) that the publication was being distributed among the leadership before public distribution, presumably for any last minute major objection. These decrees would supplement the Law on State Enterprises and other laws already passed, including the Law on Individual Labor Activity, the Law on Unearned Income, the Law on State Acceptance Commissions which verify the quality acceptability of output, and others.

Whether he has two or three years or two or three decades remaining, the major point is that there has been much ado about something. It undoubtedly needs time to work its way through the system and will need adjustments not only to counter or consider opposing viewpoints and resistance, but also to change the psychology and behavioural patterns of an entire society and economy. It is much too premature to condemn it as a complete failure, without a chance to achieve even limited success--which limited success is my expectation of what they will achieve--and to satisfy the requirements of the Politburo, the military and the population. Hopefully the trend in arms control and foreign policy will not only give Gorbachev's "administration" a chance to improve the lot of the individual citizen of the Soviet Union, but also to possibly convince the leadership that this approach to international relationships is preferable to one of constant potential for misunderstanding and conflict.

That the reforms may turn out to be a "two-edged" sword which can change their long-term goals into one of genuine peaceful coexistence between social systems, to use their terminology, is perhaps an unforeseen consequence of the initial selection of Gorbachev to reform the Soviet economy and society which was essential to make them stronger in the military and foreign policy arenas. But if the "two-edged" sword cuts back into a demand by party members, by the intelligentsia, by the population for a further reform of policy, this may be the most significant change of all.

[1] M. S. Gorbachev, "On the Five-Year Plan Of Economic and Social Development of the USSR for 1986-90 and Party Organizations' Tasks to Implement It," Pravda, 17 June 1986, translated in BBC, Summary of World Broadcasts, Part 1, The USSR, 19 June 1986, p. 3.

[2] "The Fundamental Question of Restructuring; Conference at the CPSU Central Committee," Pravda, 13 June 1987, pp. 1-3, translated in FBIS, Daily Report, Soviet Union, 16 June 1987, p. R4.

[3] Soviet Television interview with Academician Viktor G. Afanasyev, 19 July 1986, as reported in BBC, Summary of World Broadcasts, Part 1, The USSR, 28 July 1986, p. 3.

[4] M. S. Gorbachev, "On the Five-Year Plan Of Economic and Social Development of the USSR for 1986-90 and Party Organizations' Tasks to Implement It," Pravda, 17 June 1986, translated in BBC, Summary of World Broadcasts, Part 1, The USSR, 19 June 1986, p. 8.

[5] "The Fundamental Question of Restructuring; Conference at the CPSU Central Committee," Pravda, 13 June 1987, pp. 1-3, translated in FBIS, Daily Report, Soviet Union, 16 June 1987, p. 7.

[6] M. S. Gorbachev, "On the Five-Year Plan Of Economic and Social Development of the USSR for 1986-90 and Party Organizations' Tasks to Implement It," Pravda, 17 June 1986, translated in BBC, Summary of World Broadcasts, Part 1, The USSR, 19 June 1986, p. 14.

[7] Ibid., p. 8.

[8] Ibid., p. 6.

[9] "The Fundamental Question of Restructuring; Conference at the CPSU Central Committee," Pravda, 13 June 1987, pp. 1-3, translated in FBIS, Daily Report, Soviet Union, 16 June 1987, p. R 15.

[10] Ibid., p. R 18.

[11] M. S. Gorbachev, "On the Five-Year Plan Of Economic and Social Development of the USSR for 1986-90 and Party Organizations' Tasks to Implement It," Pravda, 17 June 1986, translated in BBC, Summary of World Broadcasts, Part 1, The USSR, 19 June 1986, p. 15.

[12] "The Fundamental Question of Restructuring; Conference at the CPSU Central Committee," Pravda, 13 June 1987, pp. 1-3, translated in FBIS, Daily Report, Soviet Union, 16 June 1987, p. 3.

[13] Ibid., p. 6.

[14] See Social Indicators and the Politburo, by Dr. Murray Feshbach, OSD Project no. MDA 903-85-K-0097, August 1987, pp.

[15] A. A. Gromyko, "On the Draft Law On the Nationwide Discussion of Important Questions of State Life," *Pravda*, 1 July 1987, p. 5, translated in *Current Digest of the Soviet Press*, vol. XXXIX, No. 28, 12 Aug. 1987, p. 10.

[16] *Ibid.*, p. 11.

[17] M. S. Gorbachev, "On the Five-Year Plan Of Economic and Social Development of the USSR for 1986-90 and Party Organizations' Tasks to Implement It," *Pravda*, 17 June 1986, translated in BBC, *Summary of World Broadcasts, Part 1, The USSR*, 19 June 1986, p. 23.

[18] *Ibid.*, p. 20.

[19] "Interview with Valentin Falin," *Sueddeutsche Zeitung*, 19 June 1987, p. 3, translated in FBIS, *Daily Report, Soviet Union*, 19 June 1987, p. R4.

[20] *Ibid.*, p. R3.

[21] Hungarian television interview with Nikolay Shishlin, 28 June 1987, as reported in *Summary of World Broadcasts, Part 1, The USSR*, 1 July 1987, p. B/1.

[22] Soviet Television interview with Academician Viktor G. Afanasyev, 19 July 1986, as reported in BBC, *Summary of World Broadcasts, Part 1, The USSR*, 28 July 1986, p. 3.

[23] T. I. Zaslavskaya, "The Guarantee of Success Is Our Own Actions," *Izvestiya*, 21 April 1987, p. 3, translated in JPRS, *Soviet Union, Political Affairs*, 4 June 1987, p. 89.

[24] "Interview with T. I. Zaslavskaya, *Nepszabadsag*, translated in FBIS, *Summary of World Broadcasts, Part 1, The USSR*, 31 January 1987, p. C/2.

[25] "Interview with Valentin Falin," *Suddeutsche Zeitung*, 19 June 1987, p. 3, translated in FBIS, *Daily Report, Soviet Union*, 19 June 1987, p. R4.

[26] S. L. Sokolov, "Speech by Sokolov," *Pravda*, 2 March 1986, p. 6.

[27] "Only an intensive economy, developing on the most advanced scientific-technical base, will provide a reliable ground for ...strengthening the country's position in the international arena and enabling it to ewnter into the new millenium with dignity as a prospering great power." From *Pravda*, 11 December 1984, cited in Heinrich Vogel and Hans-Henning Schroder, "Security Aspects of Science and Technology in the USSR," in Murray Feshbach (Ed.), *National Security Issues of the USSR*, Workshop held at NATO Headquarters, Brussels, Belgium, November 6-7,1986, Dordrecht, The Netherlands, Martinus Nijhoff, 1987, p. 111. Also see especially on this point, the contributions by Seymour Goodman, Philip Hanson

and John P. Hardt in this volume.

[28] See Vedmosti Verkhovnogo Soveta SSSR, no. 37, 10 Sept. 1986

[29] Ekonomicheskaya gazeta, 16 July 1987, p. 3.

[30] Mark D'Anastasio, "Soviets Implement Law to Curtail Power of State Economic Planners," The Wall Street Journal, 7 Aug. 1987, p. 17.

Senator **Proxmire** [presiding]. Thank you, Mr. Feshbach. You have made some wonderful contributions to us over the years. We have had nine publications on the Soviet Union since 1959, and you contributed to every single one of them. You are the only one who has, and you are obviously a remarkable scholar in this area.

Our final witness on the panel is Mr. Abe Becker of the Rand Corp. Mr. Becker, we are delighted to have you.

STATEMENT OF ABRAHAM S. BECKER, ECONOMICS AND STATISTICS DEPARTMENT, RAND CORP.

Mr. **Becker**. Thank you very much, Mr. Chairman, and thank you for inviting me to come and talk about this very interesting and important subject of reform in the Soviet Union.

I would like to summarize my prepared statement very briefly and note that I am dealing with two sets of issues.

Senator **Proxmire**. We appreciate that, Mr. Becker, and your statement will be printed in full in the record.

Mr. **Becker**. In the first part, I deal with the relationship between what, for shorthand purposes, I have called modernization and, on the other side, economic and political reform; and in the second part, I talk about a few political-military implications of that relationship that appear to me to be important.

This is a very large subject and I only touch on just a few issues. Others may consider still other implications equally important.

MODERNIZATION

On the first part, what I mean by "modernization" is essentially the combined tasks of getting the economy moving again, of accelerating economic growth and, at the same time, of a qualitative transformation of the structure of output. This is a task that Gorbachev sees as reaching across the board. So let us call that "modernization" for brevity.

NEED FOR REFORM

In this country, as well as in the West generally, we talk a lot about the Soviet economic reform which catches our imagination. But I would like to suggest that modernization is really closest to Gorbachev's heart, that this is the impelling force of the policy he outlined when he came into office; this is the mandate that he actually received from the party; that Gorbachev was not initially a "radical" reformer; and to the extent that he is now, he is so only because of the force of circumstances, because of his realization that the requirements of modernization drive him and the party in directions that were originally not really contemplated, in the directions of more radical reform.

If he is one, then, it is the logic of events that has pushed him onto that path. The requirements for modernization seem to suggest that there have to be changes in the processes, in the organizational forms, in the incentives of the entire economic system. And at a second remove, if economic reform is required in order to pursue modernization, it becomes clear that in order to involve the population, in order to get them to behave like active agents of change, a great deal of political change is called for, a set of political changes that Gorbachev calls democratization.

OUTLOOK

Now, it seems to me that as he has pursued this line in following the logic of events, he has incurred a great deal more resistance. I think that modernization per se did not call forth a great deal of opposition. Footdragging, bureaucratic resistance, yes; but the kind of opposition that is occurring now, it seems to me, is ascribable to the fact that the rhetoric and the policy is being pushed in directions that are far more difficult, more unthinkable to much of the Soviet political elite when Gorbachev came into office.

This raises a very interesting question of the intertwining between these two forces of modernization and economic reform. If, as I think, Gorbachev is a modernizer above all, and reform for him is really largely instrumental, will his zeal for reform weaken if modernization succeeds? Or is he so committed to reform by now that even success will not stop him on the path to reform?

The fact is, however, that modernization is not completely successful by a long shot. It has a very mixed record, and the likelihood in the future is by no means guaranteed. Therefore, the line of argument would suggest that as these obstacles are more clearly perceived, there will be a need for extension of the reforms in the directions that are conceptually apparent now, that will push them in a more radical direction. So that if modernization continues to falter, one might argue, "radical" reform will have to pick up, too.

Will it proceed in a direction of market socialism and political pluralism? What about the forces of reaction and conservatism that are already taking umbrage and are already very much concerned about the scope of the changes that are just in the planning stage? I don't think that anyone can predict what will happen. I think that what Gorbachev has succeeded in doing is essentially prying open Pandora's box and the forces that are being let loose may not be really subject to his control.

MILITARY SIGNIFICANCE

Let me now proceed briefly to the question of the political military significance of what is taking place. There is an immediate short-term kind of relationship which, I think, is fairly generally realized, and that refers to the fact that modernization is the core of Gorbachev's domestic economic program, and the domestic economic issue and problem has been given first priority in his efforts.

He has said this numerous times. He has made it very clear that what he wants, above all, is the opportunity to be able to resolve the domestic economic difficulties that he sees as the most important obstacle to bringing the Soviet Union into the 21st century as a world class power.

But to carry that out, he has got to—well, you can choose your military image—protect his flank, stabilize the other front. That is, he must prevent the external threat from interfering with his efforts to concentrate forces on the solution of the domestic economic problem.

Now, this has concrete manifestations and the most important and the best known, I think, is arms control diplomacy. There are many dimensions involved in Gorbachev's arms control policy. There is the question of the personality of Gorbachev. There is the question of changes in Soviet military thinking. But I don't think that one can look at the vigor, flexibility, and determination of this arms control policy without recognizing that it must relate to a perceived need for an economic breather, for the economic peredyshka, the Leninist term for a chance to recuperate, to recoup forces in order to move on to the next stage.

A less prominent manifestation which I will skip over now for lack of time is what I see as the lower profile of the Soviet Union in the Third World and a lesser degree of readiness to use Soviet resources for the benefit of Third World customers.

LONG-TERM IMPLICATIONS OF MODERNIZATION

Now, the long-term implications seem to me to be much more important and I want to dwell on these for a couple of minutes. My focus here is on the civil-military significance of modernization. The heart of modernization is machine building. The heart of machine building is the high technology branches of electronics, computers, robotics, instruments, and computer-regulated machine tools.

Modernization and machine building are designed to reequip the economy, to bring the economy up to world standards, but modernization also means the development of the hi-tech foundations of a modern military structure, of military hardware for the 21st century.

SHORT-TERM CONSTRAINTS

None of this is going to happen overnight. This is something that is not likely to make its appearance until the next decade, but it is of fundamental importance, it seems to me. It has a number of different implications.

First, with regard to domestic politics, in this program Gorbachev is consciously or unconsciously realizing the demands that were put forth by the high command, spearheaded by Marshal Ogarkov in the late 1970's and the early 1980's, for a qualitatively new kind of military structure. I think there is an implicit bargain between the party and the military, in which the military recognizes that a short-term constraint on the military budget, in the sense of slow growth or perhaps even no growth in military procurement, is worth pursuing if it means that in exchange there is the possibility for a radical transformation of the qualitative base of the armed forces.

Second, it has important arms control implications. To begin with, here is another reason for Soviet opposition to the American SDI. It is not just the question of the immediate threat of SDI to the Soviet domestic program, but there is also the issue of Soviet hopes of being able to catch up in 10 or 15 years if they can in the meantime constrain the scale and the pace of American military progress in space.

Further, high technology in the military field is not restricted to nuclear weapons. Perhaps even more important is conventional military technology. And again, we are back to themes that were highlighted by Marshal Ogarkov in the late 1970's and the early 1980's.

The issue here has to be understood in a particular context. We have a Soviet leadership which talks about buying into concepts of denuclearization, perhaps even complete denuclearization. In any case, it is recognizing the far greater importance of conventional forces in the modern world.

The Soviet Union now has quantitative but not qualitative superiority in conventional forces. Moscow would like to constrain the growth of American and Western qualitative capabilities while working hard on the Soviet modernization program.

I suggest that this has two implications of its own, with which I will conclude:

First, conventional arms control negotiations with the Soviet Union are going to be extraordinarily difficult. It must be our aim to achieve asymmetrical reductions of Soviet forces. It will be the Soviet aim to maintain quantitative superiority until quantitative superiority can be joined to qualitative.

Finally, what does this mean for our understanding of Gorbachev, the man, and his aspirations for the Soviet Union? The scenario of a Soviet Union which enters the 21st century with an advanced economy and with a qualitatively transformed military structure is of a Soviet Union that represents a formidable adversary.

[The prepared statement of Mr. Becker follows:]

GORBACHEV'S PROGRAM FOR ECONOMIC MODERNIZATION AND REFORM: SOME IMPORTANT POLITICAL-MILITARY IMPLICATIONS *

Abraham S. Becker

Two themes dominate Mikhail Gorbachev's domestic economic program, acceleration-modernization and reform. My presentation today examines the interrelation of these two themes and their military and foreign policy implications. I will argue, first, that economic reform and its social-political twin, democratization, are derivative values. This does not diminish their potential significance for Soviet society, but it complicates any assessment of likely outcomes of high-level conflict over *perestroika* (restructuring). My second main point is that the interrelationship of acceleration-modernization and reform has profound military and foreign policy implications.

THE RELATION OF MODERNIZATION AND REFORM

Modernization, Gorbachev tells us increasingly, depends on reform. Will reform depend on the success of modernization or, paradoxically, on its difficulties?

Gorbachev came into office with an apparently deeply-felt sense of impending crisis. This perception was drawn from his observation of the extent and scope of internal decay in all spheres -- political, social as well as economic. He chose to concentrate his attack first on the economy, viewing it as the key to efforts in other spheres. His main concern was made clear at the very start -- to extract the economy from the trap of the "extensive" growth model -- declining output growth through diminishing rates of increase of labor and capital inputs and stagnant or even falling productivity:

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* Prepared for presentation before the Joint Economic Committee, Subcommittee on National Security Economics and Trade, U.S. Congress, on September 10, 1987.

> We will have to achieve a decisive turn in switching the national economy onto the tracks of intensive development. We must, we are obliged, in a short time to attain the most advanced scientific and technical positions and to reach the highest world level in the productivity of social labor (*Pravda*, March 12, 1985).

In this and in many other statements that followed each other in rapid succession during his first months in office, Gorbachev advanced two main goals: acceleration of output growth, which had fallen by CIA's estimate for GNP to under 2 percent per year, and across-the-board transformation of the qualitative structure of output.

> What we need is revolutionary change, a transfer to fundamentally new technological systems, to the most up-to-date machinery to provide the very greatest efficiency. Essentially it is a matter of reequipping all sectors of the national economy on the basis of contemporary achievements in science and technology (*Pravda*, April 24, 1985).

To get the economy "moving again," however, Gorbachev had to do something about the abysmal state of the "human factor" in production -- the defeatism, indifference, corruption, drunkenness and general indiscipline that permeated the labor force from factory benches to ministerial offices. Andropov was his clear mentor in this: "Although everything cannot be reduced to discipline, it is with discipline that we must begin, comrades" (*Pravda*, February 1, 1983). Just as tightening of discipline was a means to the main ends, so economic reform also appeared to be instrumental:

> By making extensive use of the achievements of the scientific-technical revolution and by making the forms of socialist economic management accord with contemporary conditions and demands, we should achieve a considerable speeding up of social and economic progress, There is simply no other way (*Pravda*, April 24, 1985).

The term "reform" was not common in the first months of the new regime. Change may have been deemed urgent, but it was characterized as "perfecting the economic mechanism." The substantive content of the reform package was vague but quite familiar in its general form: strengthening both central planning and enterprise rights; eliminating "superfluous" links in the administrative hierarchy; enhancing economic incentives, etc.

At that early stage, then, Gorbachev seemed wholeheartedly and impatiently committed to the revitalization and qualitative transformation of the economy -- let us call that goal "modernization," for brevity. He showed no such commitment to "radical reform," not just as Western economists might define it, but even as many prominent Soviet writers had called for. It was not until the 27th Party Congress in February 1986 that Gorbachev used the term "radical reform," and at that only once in his major report. It was only in the second year of his regime that the rhetoric of reform and the character of the proposals being aired, especially with the publication of the draft Law on Enterprises, turned truly "radical" in Soviet terms. Also in this period, the reform discussion was pushed into a new dimension, *demokratizatsiia*, highlighted by the January 1987 Party Plenum and the debate on electoral reform.

The evolution of these strands of the Gorbachev program strongly suggest that Gorbachev became a "radical" reformer in spite of himself, led on by the force of events. His speeches indicate that he became increasingly aware of the obstructive power of the economic system, a force which could not be overcome by the major initiatives of the first year -- the discipline campaign or the administrative reorganizations (e.g., the super-agricultural-ministry, *Gosagroprom* -- the State Agro-Industrial Committee -- and the machine-building bureau set up, apparently, to supervise the civilian machinery ministries), or the limited industrial-incentive changes involved in the universalization of the so-called "industrial experiment." He was therefore led increasingly in the direction of enhancing enterprise autonomy, including more complete self-financing, greater reliance on wage and price differentials for incentives and production decisions, and reduction of the role of centrally administered supply in favor of decentralized distribution.

As with economic reform, so with political reform. It was probably because conditions were not changing as rapidly as he wished or hoped that he became a convert to "radical" reform measures. Economic reform was essential to the success of modernization and political reform was essential for economic reform:

> Despite the significance of the economy as the bedrock, the processes of restructuring in the economy nevertheless would not work unless they were implemented in coordination with all the other spheres of life of our society -- and above all the spiritual and political spheres, the sphere of democracy, and many others (*Pravda*, July 15, 1987)

Economic reform and democratization both appear to be extensions of Gorbachev's effort to shake up the Soviet population, to get it to shake off the old habits and to turn energetically to the tasks of modernization: The main idea of the program set forth at the January plenum is "to develop the process of democratization in order to involve people's energy and interest in all the processes of our lives. This is the most important thing, the main point of everything, comrades" (ibid).

As Gorbachev has advanced his own understanding of the requirements of modernization, he has also experienced considerably greater resistance than in the earlier stage. In the first year of his regime, there was talk about opposition but it was hardly evident in published materials. This situation has changed sharply, where opposition by particular groups to one or another aspect of *glasnost'* or *democratizatsiia* is now fully visible.* Modernization per se apparently engendered little controversy. There undoubtedly was resistance to particular measures where special interests were hurt, but there was general acceptance of the basic direction of change -- increased investment, restructured to emphasize reequipment rather than new construction and priority to high-technology machinebuilding. Economic and political reform, the apparently indefinite extension of *glasnost'* to hitherto protected areas (Stalinism, the value of collectivization, even the legitimacy of second-strike nuclear retaliation) has evoked anguished protests. So far Gorbachev has personally declared several traditional values as still sacrosanct -- state ownership of capital, central planning, the right of the Communist Party to lead the society, the unacceptability of large-scale unemployment.

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* Although not all manifestations have been allowed to make their way into the press. For example, the proceedings of the June 1987 Party plenum have not been published.

The most interesting question that this approach raises is how the fortunes of the modernization program will affect the controversy over reform. If the pace of the economy accelerates, if the machinebuilding subprogram develops rapidly, if real quality standards are raised substantially, will the drive to reform weaken? If, on the other hand, the modernization program falters, tripped up by the time-honored obstacles of overcentralization, bureaucratization, and perverse incentives, will this lead to further radicalization of the reform? It has been said that Egor Ligachev, until recently the apparent "second secretary" of the Central Committee (i.e., the most important Politburo member after Gorbachev who was also a secretary of the CC), represented the potential leader of an oppositional current whose platform would be "modernization without radical reform". Ligachev's power appear to have been weakened by the election of Aleksandr Yakovlev to the Politburo and his assumption of at least some of the "second secretary's" responsibilities. It remains to be seen how the power balance between the two will develop and how this will affect the struggle over reform.

THE POLITICAL-MILITARY SIGNIFICANCE OF MODERNIZATION AND REFORM

Modernization and reform are now the keystones of Gorbachev's domestic economic program but they also have important foreign and military policy implications. The most familiar by now is the dominant influence of the domestic economic program over the Soviet Union's foreign, including military, policy.

The idea that Soviet domestic concerns take primacy over the external interests has a long tradition in Soviet rhetoric and is enshrined in party programs and the constitution. The 1986 revision of the party program lists the internal development factor first among "the main arms and avenues of the CPSU's international policy":

> to ensure favorable conditions for the improvement of the socialist society and for the advance toward communism in the USSR, to eliminate the threat of world war and achieve universal security and disarmament.

Gorbachev has made no secret of the primacy of his domestic development aims but also of his acute sense that external factors could seriously disrupt his domestic timetable. When he came into office, he had not only serious domestic problems to deal with but also a worrisome external challenge. The U.S. military revival had been proceeding for ten years and accelerating in the last four. His predecessors' mismanagement had disrupted arms control negotiations and opened the door to a formidable deployment of U.S. intermediate range weapons, ballistic and cruise missiles, in western Europe. To be able to concentrate on internal problems, Gorbachev needed to stabilize and constrain the external threat. Failing that, politics and security considerations would force him to make some sort of military response which could compromise the future of the domestic modernization program. Thus, when Gorbachev assured the International Forum on Peace and Disarmament, meeting in Moscow on February 16, 1987 (*New York Times*, February 17, 1987),

> Before my people, before you and before the world, I state with full responsibility that our international policy is more than ever determined by our domestic policy, by our interest in concentrating on constructive endeavors to improve our country,

the message was plausible and credible. Indeed, he had said essentially the same thing many times before.

What are the concrete manifestations of that effort to stabilize the external in order to concentrate forces on the domestic front? The first and most important is surely Gorbachev's arms control diplomacy. There are other dimensions to this part of the Politburo's recent foreign policy, including perhaps a revised perception of the possibilities for and requirements of Soviet security in an age of nuclear parity. Another, regarding internal politics, is mentioned below. It is difficult to believe, however, that the extraordinary range of Soviet concession in both START and INF negotiations, after years of immobilism, is not directly connected to the leadership's desire to achieve a breathing spell in order to pursue its domestic programs without the threat of externally generated disruption.

We might also ascribe to the same motives the apparent lowering of the Kremlin's profile in and scope of commitment to Third World involvement. Gorbachev has extended his "sympathies" to the revolutionaries of the Third World but little else, and his statments on Soviet policy in this sphere have been conspicuous for their thinness and blandness. * The volume of arms transfers to the non-communists LCDs continues high, in considerable part for their contribution to easing Soviet balance of payments difficulties.** Economic aid, apart from the continued support of Moscow's chief Third-World communist allies, Cuba and Vietnam, is being held on a shorter leash. Even to the communist allies Soviet generosity is limited. Reuters reported (May 15, 1987) that the volume of military and to Vietnam in 1986 was 5 percent less than in 1985 and the military assistance to the Kanpuchean regime was cut 43 percent compared to the 1985 level.

Perhaps even more important is the longer-term political-military significance of the domestic economic program. This is connected with the dual use of the high priority branches of machinebuilding. As noted earlier, Gorbachev's program for modernization of the Soviet economy is intended to extend across the board. The heart of the program, however, is machinebuilding, and within it, especially the high technology branches--electronics, computers, robotics. Machinebuilding, of course, produces the means of reequipping other branches of the economy, and high technology is the key to reaching world standards of productivity. At the same time, however, the high technology sector is also critical to the military development of the state.

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* Francis Fukuyama, "Soviet Strategy in the Third World," in Andrzej Korbonski and Francis Fukuyama, *The Soviet Union and the Third World. The Last Three Decades*, Cornell University Press, 1987, pp. 41-42.

** Abraham S. Becker, "A Note on Soviet Arms Transfers to the Middle East," Steven L. Spiegel, ed., *The Soviet-American Competition in the Middle East*, Lexington Books, D.C. Heath & Co., in press.

A familiar theme of military writings of the 1970s was the wide-varying effects of the "intensifying scientific-technological revolution," particularly in increasing the rate of obsolescence of military technology. Most of this discussion referred to nuclear weaponry, but Marshal Ogarkov, the chief of the general staff from 1976 to 1984, was the most prominent voice among a group of officers calling attention to the rapidity of technical change in conventional warfare. Ogarkov warned that the United States was becoming fully engaged in the revolution in conventional military technology, and he was concerned that it was just in these information-based technologies that the qualitative gap between the United States and the Soviet Union was greatest. In the condition of near economic stagnation that characterized the USSR during the last Brezhnev years and the Andropov-Chernenko interregnum, the military high command must have feared that the USSR would inevitably fall further behind in the technological race.

Ogarkov is no longer in the center of the policymaking process, but he may well believe that Gorbachev's economic program, at long last, has the potential for coping with this most important military challenge. That is, in setting out to modernize Soviet industry by concentrating on the development of machinery and particularly its high technology branches, the Gorbachev regime is also creating the foundation for advanced military technology as well. The argument is well-summarized by Major-General M. Iasiukov.

> In the matter of strengthening military-economic potential, it is difficult today to overestimate the party's concern for cardinal acceleration of scientific-technical progress. After all, the leading directions of scientific-technical progress--

> the further, priority development of machine-building, particularly machine tool-building, robot technology, computer technology, instrument-making, and electronics--are simultaneously the basic catalysts of military-technical progress.
>
> Today what is required for serial production of contemporary weapons and the newest combat equipment is not usual or ordinary equipment but the most modern and frequently unique equipment--new in principal instruments, numerically-controlled machine-tools, robot equipment, latest generation computers, and flexible manufacturing systems. In other words, the present stage of the military-technical competition that has been imposed on us by imperialism demands a high level of development of those branches of industry with the best prospects, of the most modern technology, and of a highly qualified workforce. *

This is not the place to expatiate on the long-term military significance of this duality, but a few comments can suggest the line of argument. If Gorbachev succeeds in generally reaching the quantitative and qualitative goals of the modernization program, he should simultaneously be establishing the foundations of a qualitative transformation of Soviet military technology, including in the conventional sphere. At least two arms control implications immediately spring to mind. First, if this is the military-economic perspective of the Soviet high command, it would be entirely logical for the Kremlim to seek to halt or retard the U.S. Strategic Defense Initiative pending the development of a Soviet industrial capability to compete in this space dimension of high technology.

Second, there seems to be increasing discussion of conventional arms control to regulate the competition in at least a partially denuclearized bipolar world. Western discussions of this subject generally emphasize the quantitative superiority of Soviet and bloc conventional forces in the European theater. Obviously, it would be of first importance to prevent the Soviet Union's augmentation of its quantitative margin by rapid qualitative improvement. On the Soviet side, the task may be seen as retaining sufficient quantitative margin

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* Major General M. Iasiukov, "Voennaia politika KPSS: sushchnost', soderzhanie," *Kommunist vooruzhennykh sil,* October 1985, p. 20.

while constraining the adversary's qualitative development, until the modernization program bears fruit in the 1990s. Conventional arms talks, if they get started, will pose no fewer difficulties than their nuclear counterparts.

The dual character of Gorbachev's modernization program is also significant for the state and further development of civil-military relations in the USSR. It seems clear that in the late 1970s and early 1980s there was serious conflict between the party and the military high command, spearheaded by Marshal Ogarkov. The conflict was about many things, including the state of readiness of the Soviet economy and the armed forces for war, the degree of threat presented by the American military buildup, the Brezhnev changes in military doctrine and policy, among others. It was also very much about the adequacy of the military budget. Marshal Ogarkov was removed from the central political arena in September 1984, but that action could not in itself remove the sources of military discontent. The real growth of military spending and of its main investment component, military procurement, turned up in 1985 and 1986, according to CIA and DIA estimates.* The estimates are subject to change and it is not clear whether the upturn will last. In any case, the increases are relatively modest and there may be a more solid basis for understanding between the party and the military in the modernization program: The high command may still be bound by a tight budgetary constraint, although perhaps a bit looser than in the previous years; nevertheless, the military leadership may be prepared to tolerate that in exchange for the promise of major improvement in military quality held out by the modernization program.

Logic argues that this (implicit ?) bargain between the party and the military, assuming it resembles reality, should be conditional. Military consent would depend first, one imagines, on holding to a minimum the sacrifice in current security interests involved in the maintenance of relatively low military budget growth. This suggests an additional explanation of the extraordinary effort Gorbachev has put into arms control diplomacy. A constraint on Western military modernization is necessary to protect not only the Soviet domestic economic program but also the civil-military quid pro quo.

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*Joint CIA-DIA paper, "Gorbachev's Modernization Program: A Status Report," presented to this Subcommittee, March 19, 1987.

Another element of this condition for military acquiescence brings us back to the interrelation of reform and modernization. The U.S. intelligence community believes that there is sufficient military industrial capacity to support the Soviet procurement programs that appear to be on the books at least through the end of the decade. Nevertheless, CIA and DIA did not rule out civil-military competition over supplies of skilled labor, scarce components and materials.* There may also be competition for the very capacity of defense machinebuilding, which was allocated some of the best quality machinery in the areas that are now of high development priority--for example, flexible manufacturing systems and computer-operated machine tools. The extent of such competition will depend on the success of the civilian modernization program, particularly on the ability of planners to maintain a balance between the demand for new high-technology equipment and the pace of construction of the machinebuilding capacity required to produce the equipment.

A second logical condition of the military's adherence to the presumed bargain is that the bright promise of military modernization in the future appears realizable. In this sense, too, the success of the modernization-reform package becomes an important political foundation of party-military relations.

It will be argued that recent months have brought signs of a worsening of civil-military relations, highlighted by the aftermath of the West German Cessna landing in Red Square. The armed forces and some of its leading personnel have come in for unprecedented criticism, from both intellectuals and from the party hierarchy. Gorbachev may well have strengthened his control over the military in the process, but one wonders at the depth and strength of the resentments this may have left behind. The harsher tone of civil-military relations in recent months may, however, only underscore the political importance to Gorbachev of domestic economic advance: Success of the modernization program would

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*Ibid and *Allocation of Resources in the Soviet Union and China -- 1985*, Joint Economic Committee, 1986, p. 22.

enhance Gorbachev's maneuver space--in dealing with the conflict over economic and political reform, in coping with the long range threat of western military power, and, not least, in ensuring his own hold on power, the prerequisite to meeting any of his other objectives.

OUTLOOK FOR GORBACHEV

Senator **Proxmire**. Thank you very much, Mr. Becker, for another very fine statement.

Professor Goldman, you stated something that shocked and surprised me very much. You said that Gorbachev might not last more than 2 or 3 years because of opposition to his reforms and the risks of failure.

In fact, you conclude, reading your last sentence: "Given the magnitude of his task, the odds that he will succeed do not seem to be in his favor."

That shocks me because, of course, all of us were struck by his relative youth compared to previous leaders of the Soviet Union and even compared to our President. You seem to be saying he is not going to outlast Ronald Reagan by very much.

What would be the consequences of his departure? Will we go back to Stalinism?

Mr. **Goldman**. No, I don't think so. When Khrushchev was thrown out, the Soviet Union didn't go back to Stalinism. There was retention of some of the reforms that Khrushchev introduced, but many of the reforms that Khrushchev introduced or were being introduced at that time as part of the Liberman economic reforms, and some that were picked up by Kosygin, ultimately disappeared.

Certainly the cultural thaw that we saw in the 1950's disappeared. We did not see a return to people arbitrarily being sent to camps and being executed. That certainly did not reappear.

I would think that we would probably see the same kind of process taking place after Gorbachev. Some things would be retained. But I think that the state bureaucracy and the party would insist that there be, to coin a phrase, fewer hair-brained programs—that is, of course, what Khrushchev was accused of—that there be more stability in the system, that we go slower.

Indeed, there are some people who are asking what is all the fuss about? We were growing before all right. We were growing faster than most market economies were growing as we conventionally define gross national product. In other words, we were making steel, so what was the problem?

Well, it turned out that the steel was no good and nobody wanted it. That is the problem. But as you look at the statistics, they may come back to haunt those who are advocates of reform just for that reason.

So I would answer your question explicitly: There will be some retention of some of the improvements, maybe more power to some of the enterprises, but the Gosplan will reassert its authority, the bureaucrats will assert their authority, and the party will continue, I would expect, to dominate. There would be less emphasis on glasnost', more return to censorship, and a repression of some of the individual interest groups that we have seen—the Kazaks, the Tartars, the Jews. I think there would be a return in that sense to more of the status quo ante.

ARMS CONTROL

Senator **Proxmire**. What happens to the opportunities for arms control?

Mr. **Goldman**. That is a good question, Senator, and I think that the arms control issue probably will still move ahead.

Senator **Proxmire**. It has moved ahead pretty sharply, it seems to me. At least the perception is that he has tried to enter into a competition with us to make people in Europe particularly, also in this country, feel that he is a man of peace and that he is anxious to control arms. He is willing to reduce the Soviet military in both convention and nuclear and so on.

Mr. **Goldman**. I think you are right; he has done a good job in that sense. But I think that sometimes we put too much emphasis on how is he playing in Paris, rather than how is he playing in Moscow. There is no doubt that he keeps one ear and one eye open to see how he is playing overseas, but at the same time in my mind, I think he is mainly concerned about how he is playing at home.

I think he is doing this, and I would agree with Abe Becker when he said that modernization is at the forefront. I think that what is happening is that Gorbachev is looking to see how he can get his modernization through, how can he bring the Soviet Union into the 20th century? I think he will settle for that right now and worry about the 21st century later. He has to do that. They are still in the 19th century.

And to do that, economic reform has to come first. Economic reform can only come if he can do something to reduce the expenditures that are going to the military sector, as was discussed in the first presentation this morning. Therefore, he is determined to move ahead on arms control because, if nothing else, it will give him additional time, breathing space if you will, so he can pursue these reforms. And at least he can show that he has come back from Washington to the Soviet Union and that perestroika, his reforms, have done something. They have given him peace in his time, and that will give him additional time to worry and fighting the bureaucracy and the party.

Senator **Proxmire**. Professor Feshbach, how do you feel about the future of Gorbachev and how that relates to arms control? To be specific about it, how would it affect the Comprehensive Test Ban Treaty, for example, if the next President should go for that?

OUTLOOK FOR GORBACHEV

Mr. **Feshbach**. My basic feeling is, first, that Gorbachev is not going to be out of power in the next few weeks or few years, but that he will continue. And he will continue because there is a full realization that they need to make major changes in their entire society, economy, military and science and technology; that you cannot look at only one, you have to look at it all the way across the board. You have to change it in a very dramatic way.

Regarding Marshall's point about 19th century and 20th century—I think that in some cases they are in the 20th already, but let's say in many cases they are further back, 30 or 40 years, maybe not as far as the 19th century.

As to the agreement, I think again the word that I used was pause, or breather, or peredyshka that Abe Becker used. I think that is again the issue of short-term versus long-term policies. In the long-term policy, I do not see the fundamental change yet, but I think there is a possibility for it being like a two-edged sword, that all these changes in their economy and society might change their perceived foreign and military policies.

ARMS CONTROL

As to getting arms control agreements, I believed for a while that there would be an INF agreement, first a medium range and then a short range. The issue of chemicals, which have not been brought up, as well as conventional arms agreements, of course, is very difficult. It certainly is part of the resource allocation issue, which he needs at least in the present to, if not reduce defense expenditures, not to increase them anyway to taking a larger proportion of the GNP, whatever that GNP is.

SOVIET STATISTICS

As we know, in fact, Soviet statistics are now even more up for grabs in terms of their quality and they have just changed the Central Statistical Administration into a State Committee for Statistics. Now, one issue is the name. The other is, what is the actual job going to be done?

Unfortunately, or fortunately, as the case may be, they reappointed the same gentleman to be the head of it who was the head of it under the immediately prior period of time. He had been First Deputy Chief for many years under Volodarskiy.

That being the case, we may in fact see a different kind of reduction if they give us more realistic figures. Not so much for ourselves; they need it for themselves in order to understand where they really stand.

TEST BAN TREATY

That being the case, the test ban treaty and the zero zeros and the other agreements, I think they would go for it from a military-political kind of viewpoint, but being very careful about the military-technical point of view. That is, a distinction between the party program and doctrine versus the military doctrine.

MILITARY DOCTRINE

Now, whether the Warsaw Revised Military Doctrine Statement of several months ago is a real change in doctrine, I think is too early to tell because you do not see the play out of it, the ripple effect of it, in the organization of the military yet. You do not see it in the kinds of equipment that they are building, the composition of what exactly are they building. You do not see it yet in the kinds of military exercises which they conduct, which until now have largely been offensive in nature, while ours in the West, NATO, are largely designed to be defensive exercises in nature.

OUTLOOK FOR MODERNIZATION

However, that all takes time, but it also has economic implications. The economic implication is how much do you need for sufficient defense. And all of this relates to the modernization program and new technology, but it also relates to the health of the society, whether it be in terms that I have written in the past of population and health services per se, or whether it is in terms of satisfying the consumer goods demand of the population. All of these are linked together, and I do not see how he can break it easily.

But to replace him and to go back like the Khrushchev reforms—the Khrushchev reforms only dealt with industry and agriculture. He disturbed the party very much by splitting the party into industrial and agricultural components. He really did not play with prices, he really did not play with many of the things necessary for a real reform. The Liberman reforms were strictly a numerical quantitative measure of the rate of profits. It was the amount of profits divided by basic and working capital. That is all it was; it was not real reform. It was strictly a statistical measure if you wish.

This now, I think, is an attempt or the beginning of an attempt, after he has now set the agenda, to go further, to enable all of these other things to take place.

Senator **Proxmire**. Thank you, Mr. Feshbach. Congressman Fish.

NEED FOR REFORM

Representative **Fish**. Thank you, Mr. Chairman. I think each one of you has commented to summarize briefly the need for economic reform. I just wonder if I could perhaps get a more detailed, succinct statement in the record. I realize we are sort of going back now to the beginning of this.

Mr. Goldman, you have talked about the resistance to reform, the dilemmas that have returned that the leadership faces. One of you used the phrase, "we're making steel so why do we have to bother with anything?"

The fact of the matter is that during the time in which the Soviet Union has attained the status of a military superpower, most of that time and certainly the last 15 years has been accompanied with a sluggish economy. So my question is, what is driving reform? Why can't they continue as it is without these quite radical changes?

Mr. **Goldman**. They can continue the system as it is. There is no reason why the Soviet Union has to be the world's leading industrial technological power.

You go back to the 19th century, and Russia was a third-rate power a good portion of the century. Not everybody has to be No. 1. There are some who worry about where we will be in the United States compared to Asia or to Japan.

TURNING POINT

So what is driving Gorbachev? I think Gorbachev sees that right now there is a turning point. It is not just that the Soviet Union can continue doing what it is doing, making these goods that nobody wants, not caring for its population, whether it be health, or whether it be just consumer goods. The system is not producing in the way that it was designed.

I think Gorbachev in some sense is a patriot. I wrote that once and somebody said, "Have you gone off your mind? How can you call him a patriot?" I said, "I didn't mean he is an American patriot. I mean he's a Soviet patriot." He looks at his population and he asks what has 70 years of communism brought his people? Not very much.

At one point in the 1950's, he could be very proud of what was happening in terms of how quickly the society was growing. Now that growth has been transformed and there is a junction, and that junction is high technology. If you don't make the right changes now, you run the risk of missing not the train, but the plane or the rocket, whatever it might be, if you want to follow through with the analogy.

COMPUTERS AND TELECOMMUNICATIONS

Because technology moves so fast, there is something I call a technology gap. If you look at the Soviet Union, you are shocked by how crude the telephone system is and how backward the computer industry is. You would think those would be critical things. Well, why don't they have better computers? Why don't they have better telephones?

Look how our computer industry developed. It moved initially with a Government contract, but then it was quickly picked up by the commercial sector, and it grew with timesharing. Machines were too big. You had corporations that found that they had to have telephone services linking up the different computers. So the telephone industry had to grow to keep pace with the computers.

What made that possible? Switching equipment. What is switching equipment? Computers.

So what I want to say, without spending all morning doing it, is that the computer industry grew because the telephone industry grew. Neither one grew in the Soviet Union. How do you get the thing growing now, when the rest of the world is up here, and the Soviet Union is down here.

Gorbachev recognizes that unless he moves quickly, there will be this gap, this technology gap that he may never be able to catch up with, and he wants to improve that. He wants to bring about better goods for his population and he recognizes that the old incentive system is not producing, is not working. It is producing the wrong kinds of goods for the wrong kind of people, and you just can't keep up that way if you want to be a world force, because ultimately it will affect his military standing as well.

NEED FOR REFORM

Representative Fish. Would either of you two gentlemen care to add anything to that?

Mr. Becker. I think that there is a fairly plausible explanation for why the reform happened at this particular point. What has happened, I think, is the ever clearer demonstration of the limitations of the Soviet system as it was created by Stalin.

Now, this is an idea that has been around in the Soviet Union for a long time. It was part of the common currency of the way economic policy was discussed by and under Brezhnev. That is, the Soviet Union was seen as exhausting the possibilities of extensive development, development which was based primarily on the addition of inputs of labor and capital into the growth machine and extracting output out the other end, and that it was time to move on to the intensive mode in which you depended primarily on productivity.

But the command or directive system that the Soviet Union inherited from Stalin and from Khrushchev is just not built for intensive development. Over the past 10 or 15 years, we have had the inexorable grinding down of the rate of growth of productivity. Indeed by some measurements, the growth of productivity of both labor and capital together has been negative in most years since the early 1970's.

Gorbachev came into power behaving pretty much like a Brezhnevite, without really understanding that, or at least not giving the appearance of understanding it, and began by talking essentially about the human factor, and what he meant was really exhorting people to work harder and better.

I think that only with time he has begun to realize that the system is the problem. Because that is the case, modernization does not stand much of a chance until the system is changed in rather fundamental ways. That is why we are now witnessing a rhetoric of radical reform.

Representative **Fish**. Mr. Chairman, I understand my time is up. I hope we have a second round.

Senator **Proxmire**. By all means.

Representative **Fish**. Mr. Goldman raised the question about information explosion. My question would be the next time, how can you have an information explosion in the Soviet Union, and also maintain political control?

Senator **Proxmire**. Congressman Scheuer.

ASSESSING GORBACHEV

Representative **Scheuer**. I would like to take you all to the mountain top and ask a sort of a philosophical question. How do we evaluate the bona fides of the leadership, and how does our judgment of their credibility affect judgments we would make on many items with which we are negotiating very tough and very hard?

Now, I have had a chance to be on a congressional delegation in April that Speaker Wright took over and we spent a couple hours with Mr. Gorbachev and he is a potent guy. He is everything you have heard about him. He is brilliant, he is tough, he is knowledgeable. He has a lot of facts at his disposal that he brings out, true facts, false facts, but he brings them out at the right time to buttress his argument.

DISINFORMATION

He is very impressive and he presents himself as Senator Proxmire says, as a man of peace, as the man of the 21st century. But yet this is sort of like a Shakespeare play with five plot lines. There are another couple of plot lines in the Soviet Union, the plot line of the disinformation program on AIDS, a very sophisticated, well thought through systematic program, whereby they are trying to spread around the world this bizarre theory that the spread of AIDS is caused by the United States in some kind of a conspiratorial effort to destabilize the world.

STEALING TECHNOLOGY

The Toshiba incident. It wasn't really an incident. It was part of a systematic effort, again as Senator Proxmire said, to beg, borrow, and predominantly steal every bit of technology that they can in ways that—well, Secretary Simpson once said, "Gentlemen don't read each other's mail." Well, I guess 50 years later you say, decent governments don't have a systematic effort to steal everything that their competitors have achieved through application of resources and so forth.

EMIGRATION

Then you have the whole business of their gross continuing violation of the Helsinki Accords. We read in the papers the last couple of days, they are letting out a couple of the Refusenik leaders who many of us met several times, and that is a great big public relations glitz. But how about the 400,000 Jews who have gotten invitations to go abroad, who have an absolute right—under the international legal obligations that the Soviet Union willingly took on, they have an absolute right to leave.

ASSESSING GORBACHEV

So you have a society that is sort of on the one hand and on the other hand. On the one hand, they are credible; we want to believe that they want to stabilize the globe, that they want to move away from these escalating arms controls. But on the other hand, on another line of that Shakespeare play, they are engaged in some very, very immoral, cruel, and offensive policies that are very well thought through, that are not accidental, that they are continuing every day, and putting resources into some of those policies.

How do you sort it all out? Go ahead, Murray.

Mr. FESHBACH. First of all, I think of Gorbachev, and the bottom line, as an efficiency manager. He is trying to preserve that system as much as he can, knowing that he has to make changes, but he has two prime imperatives: the national security of the state and the preservation of the party in power. Everything else follows from that.

Now, he will give some here and he will give some there. Glasnost', which is not openness or an open society—it is frankness or candor or public airing—whatever words you want to use, it is not openness. I think that was an early-on translation that led us down a different path than we should have gone.

DOBRYNIN

Again, here you look also at his staffs, you look also at his advisers. Who did he bring back? He brought back Dobrynin which told him not so much about the White House but, if I may be very direct, how does Congress work? I do not think they really understood that until Dobrynin came back, and he brought back a lot of their U.S. specialists into that shop of his.

I think if you look at the composition of the Central Committee departments, of the Ministry departments, and how that has changed dramatically, you see a different crew in there. Again, it is for the Soviet Union. It is not for us. It is for their own agenda as they wish it to be, not what we wish it to be.

We may wish it to be a market economy, but that is not where they are going. In January of this year, he clearly stated it is not going to be a market economy.

AIDS

On AIDS, they have gotten much more sober, in the technical literature at least, and their use of this East German doctor—at first they just said German; they did not say East German, which he is, to make that allegation about Fort Detrick, et cetera—has been largely dropped. They are not very worried about the AIDS issue, and in fact they now have a new large program on testing, and a lot of our young students are having a problem over there. They are being tested by the Soviets.

FAREWELL REPORT

The Toshiba incident also relates to the Farewell Report which has not been mentioned yet here. I do not know what happened in the year and a half I was out of the country, whether it got as much attention as I think it really deserves, whether you had hearings on it or not. But the Farewell Report really detailed the efforts of the Soviets to acquire technology.

My view from Brussels, from looking at the American press, what little I saw, had practically nothing on the Farewell Report and the French revelation about the VPK as mentioned by Mr. Wigg and Abe, too.

EMIGRATION

As for the Helsinki Accords, they are playing it very clever. I think that is exactly correct. All of this is part of a more or less well thought out program. I am not trying to be eclectic in the "more or less." I think in some cases it is more; in some cases it is less; some they catch up on.

ARMS CONTROL

But if you look at all the proposals, for example, on arms control or military-related issues, it is like one every other week. I mean it is almost impossible just to keep up if you look back at the array since March 1985, since he came in. It is just unbelievable.

Again, it may be for an internal purpose, for this domestic rebuilding, but not necessarily for us, so it should be viewed within that rubric.

PACE OF CHANGE

Mr. GOLDMAN. May I suggest that we are not used to dealing with somebody like Gorbachev. As Murray Feshbach said, he is moving too fast for us. I think given the way we have traditionally regarded the Soviet Union, there is good reason for skepticism. All too often, they say look, there is a new reform. They have been calling wolf, wolf, wolf, and every time it turns out to be a sheep.

But this time there may be something else, and I think we have to look at it somewhat differently than we had before. The other day I was involved in a panel discussion with Yuri Orlov, the man who was a prisoner, who was let out along with Nicholas Danilov. And he was insisting there is no change. Nothing has gone on in the Soviet Union. He said there will be no change until there is complete amnesty of all the prisoners, until the borders are open, until there is a market society.

I thought about that for a while, and I said I don't think that is the way to look at it. I think we have to look at this Soviet Union differently today. Economists use a concept called stocks and flows, stock being the inventory, in a sense the assets, the flow being the dynamic side.

If you look at the stock, sure, there are still people in prison, although the number is being depleted. The police are still there. You are still given a hard time. It is not still a nice society. But in terms of the flow, in terms of the dynamics, something is changing. We have to recognize that. And if we don't recognize that, I think we are going to have some problems.

That is one of the reasons why I think the Europeans are so enthralled with what is happening. It is a different place. There are more people out of prison and there are more Jews being allowed to go, and we have to recognize that. And if we don't, then we may foreclose the possibility of additional change.

U.S. RESPONSE TO REFORMS

I don't want to get myself caught in one of Senator Proxmire's quagmires here, I saw how he handled the first speaker this morning. But what I am suggesting is that while I don't think Gorbachev is going to last too long, I think that he has set forth some dynamics here that are indeed suggesting change, and if we want to encourage that change we have got to recognize it and applaud it.

If every time the Soviets propose some new initiative, we say we have heard this before, or there is really nothing new, or what is the hooker in the thing, then I don't think we do ourselves justice. We should look, we should take a hard look to be sure it is for real, but if there is movement ahead we should applaud it and encourage it. Otherwise, we are not going to get more Refuseniks out. We should be delighted that they have let these dozen celebrities out, and say let's now see more, but we want to encourage you, and then start thinking about what we have to give them in exchange.

The disinformation, as Murray suggested, is not as bad as it was before but it is still there. The attempt to get technology, that was all begun in the 1970's, but it has not disappeared. But let's encourage them to get themselves more involved, to expose themselves. I think that is the way we have to go.

Mr. **Becker**. I don't think we are ever going to be able to get away from the problem of weighing the relationship between intentions and capabilities. They are both important to the development of rational policy, and on both sides of that relationship the Soviets are going to continue to give us fuzzy and confusing signals.

I would think that the first thing we ought to try to avoid is the kind of pendulumlike swings in our appreciation of Soviet intentions that has so often characterized American public perceptions and American policy. Of the many sins that such pendulumlike swings have generated, I would particularly like to avoid creating "good guys" and "bad guys": There is a "good guy" in the Kremlin and he really wants to develop a democratic society, but he is being opposed by some "bad guys."

Stalin, in some accounts in the 1940's, was the "good guy" who was being held back by Molotov, of all people. So we have a long record of making extraordinarily naive errors of that kind. Let us not make it in the future, but weigh these issues carefully, try to push as hard as we can in directions that seem to yield fruitful results, and continually measure the relationship between those factors and our own national interests. I think that is the only kind of long-term prescription that one can offer.

Representative **Scheuer**. Thank you very much, Mr. Chairman.

Senator **Proxmire**. Congressman Wylie.

ARMS CONTROL

Representative **Wylie**. Thank you, Mr. Chairman. I would like to see one of those false facts that Congressman Scheuer alluded to, but maybe you have characterized it better and called it a fuzzy signal rather than a false fact.

I think Mr. Feshbach said it right when he said that the national security is of number one consideration in all this. But I do feel, as Mr. Becker has said, that there is apparently some reason for optimism in this whole thing, and we ought to look at it in that frame of reference.

We are trying to get together on a test ban treaty, reduction in nuclear weapons. Can we continue the discussion on economic reform as maybe a forum to help in that whole discussion of a nuclear test ban treaty and reduction in nuclear weapons? You understand what I am saying.

Mr. Wigg mentioned the fact that there is a considerable interrelationship between economic reform and the security of the Soviet Union and our own national security, but he didn't mention the arms negotiations per se.

I guess my question is, what role should the West, should the United States perhaps play in this economic development process vis-a-vis discussions on the test ban treaty and nuclear weapons? Is there a direct relationship, Mr. Goldman?

Mr. **Goldman**. I think there is clearly a relationship. It may very well be that conventional weaponry takes the bulk of the budgets in both countries. But as a minimum, Gorbachev would like an arms control agreement so that he can go to his generals and say, I brought you peace in our time, and we don't have to have a further escalation in the military budget, and we don't have to embark on new weapons systems that would necessarily absorb not only resources but individuals, human capital.

DIVERTING MILITARY RESOURCES

Let's divert that capital, human and material, into the civilian sector and let them go. There have been similar arguments actually made in the United States. That is why some say we are not as competitive as we should be with the Japanese because we spend such a large percentage of our GNP on military expenditures.

So, as a minimum, he wants to stop the escalation if possible, reduce military expenditures, and in any case allow a redirection of the best manpower and the best resources into the civilian sector.

Gorbachev, if he is going to bring about his reforms, his modernization, has to go through an enormous digestive process and he has got to have everything he can going for that, supporting that, to hold off the opposition that I am convinced he is encountering.

We should be aware of the fact that there are already anti-Gorbachev graffiti appearing on Soviet walls. We never saw anything like that before. That may be part of glasnost', but it may also represent the fact that workers are asking, is all this worthwhile? And if Gorbachev can bring about an arms control agreement that will allow him to say, be patient, give me more than the 2 or 3 years that I think are going to be difficult for me, let me go ahead and carry out these reforms and I will bring you even more. So I think they are very closely related.

TRADE RELATIONS

Representative **Wylie**. In this whole process of discussion of test ban treaties and reduction of nuclear weapons and economic reform, what risks or advantages does the West, the United States more specifically, run if it tries to seriously expand its commercial ties with the U.S.S.R.?

Now, I am coming from a hearing which I chaired back in the 99th Congress, at which Secretary Baldrige appeared. He suggested, and I might say that he was for strengthening economic ties with the Soviet Union very strongly, and suggested that maybe by this process we could develop a better rapport to discuss arms reductions and nuclear weapons reductions and so forth.

Would you care to comment on that, Mr. Becker?

Mr. **Becker**. Yes. I would also like to say something a bit later about the arms control issue, but let me start with the trade problem.

GRAIN

It seems to me that there is a certain amount of illusion that is being built up on that score, and I think it is worthwhile to dwell a moment on it. U.S. trade with the Soviet Union right now is essentially U.S. grain exports. However, the Soviet Union gives every indication of wanting to free itself from dependence upon international grain markets in general and the U.S. grain market in particular.

This goal of near if not actual autarky was fundamental to the Brezhnev food program, and Gorbachev has bought onto that. He has repeated essentially the same arguments. So I would think that those in the United States who believe that we are facing a burgeoning Soviet market for U.S. grain are deluding themselves.

HARD CURRENCY

On other trade flow, which right now are miniscule, I think that the Soviet Union is going to have a very hard time with two major obstacles. The first is the question of Soviet inability to develop a broader range of exports in order to be able to expand imports, its inability to do anything other than export raw materials, gold and arms, in order to achieve hard currency balances. It is going to take a long time before the U.S.S.R. gets to the point where it sufficiently modernizes its industrial capacity so that it is a real factor as an international trade partner.

HIGH TECHNOLOGY

The other side of that coin is the question of U.S. constraints on exports of high technology, which is what the Soviet Union is interested in. It is not interested in getting obsolete technology. Our national security concerns are likely to operate for a considerable time to come to limit technology transfer to the U.S.S.R. There is room for change at the margin, but I am very doubtful that there is likely to be a very substantial transformation.

ARMS CONTROL

If you would indulge me for a moment, I would like to say something about the relationship between arms control and resource allocation. I think there is a hierarchy here that one ought to think about. It seems to me that the Soviets are primarily interested in the negative side; that is to say, in that part which represents a constraint on American and Western developments.

The issue is to prevent the kind of western racing ahead that would subject the Soviet Union to two risks: falling technologically behind in perhaps irretrievable fashion; but also upsetting the narrow balance of resource allocation that they have now in the sense of requiring a diversion of resources from civilian uses to a military response. It seems to me that the latter problem is crucial with Gorbachev, and that is what he is essentially trying to do by this frenetic arms control diplomacy: not so much to achieve large savings of resources by cutting back the armed forces immediately, but to prevent a threat to the domestic program of a huge diversion of resources.

That is what lay behind the vociferous opposition to SDI. That is what lies behind the effort to develop a nuclear arms control policy, and I think that is the essential factor behind the growing interest in conventional arms control.

There is a second element to the hierarchy and that is the competition for specific resources. A threat to the domestic program would appear in the first instance in terms of the requirement to divert very specific kinds of resources: high-quality raw materials and certain kinds of machinery capacity which are now preeminently used in military industry. It is that threat about which I think the military would be most concerned.

Third, there is the long-range tradeoff I talked about earlier; namely the sense that the military has that if it is willing to sit still for a constraint on its response to the American military threat in the short run, in the long run it may be able to buy a sharply transformed qualitative situation that will enable it to compete much more effectively with the United States.

Representative **Wylie**. Thank you. I have been given a note that my time has expired. This is extremely fascinating testimony.

DEFENSE SPENDING AND PRIORITIES

Senator **Proxmire**. It is indeed. I only have time for a quick question. Then I am going to have to leave again and yield to Congressman Scheuer, and it will be Congressman Fish's turn to question.

Let me ask you, Mr. Becker, one question. It will have to be a short question and you will have to give us a short answer.

As you know, the overall growth of Soviet defense spending has spectacularly slowed since 1975. The CIA testified before this committee that Soviet military procurement, for instance, fell from an increase of about 5 percent a year in the early 1970's to about zero in the 1980's.

Does that trend, or any other evidence, indicate a shift in resource allocation priorities from defense to the civilian sector?

Mr. **Becker**. In a negative sense, that is certainly correct. Had they not done so, they would have had to divert a significantly larger proportion of the national product for military purposes and the civilian sector would have suffered even more than it did.

Senator **Proxmire**. Are you saying that they had very little growth or practically no growth in the economy as a whole? Is that the reason?

Mr. **Becker**. In the early 1980's, there was very little growth in the economy as a whole. Had the military been able to get more, as a number of military figures demanded, the result would have been very hard on the civilian economy.

Senator **Proxmire**. I am going to have to run to the floor. Congressman Fish, I guess you are next. Congressman Scheuer will take over while I am gone.

COMMUNICATIONS TECHNOLOGY

Representative **Fish**. I hope my colleague from New York will give me a slow count here, because I have three fascinating areas I want to pursue here.

I mentioned to you, Mr. Goldman, you have given me this example of the telephone and the computer. In other words, the Soviet Union catching up with communications technology.

When they do catch up with us, they will be in the era which was called in this country the "information explosion."

My question is, can the Soviet Union enter this age without abandoning the political controls on information that characterize the system?

Mr. **Goldman**. It is going to be very difficult. That is a well-taken question. Even if they had the technology, would they be able to combine that technology with their political constraints?

That is why what Gorbachev is trying to do in the area of glasnost' is kind of intriguing because glasnost' in a sense is an effort to come to terms with the new information technology. It is disastrous. Why do they hold back computers? Because computers can be electronic bulletin boards, electronic communications. PC's are word processors, are printing presses.

When I was in the Soviet Union teaching in 1977, I used a Xerox machine. I borrowed one that an American corporation had there. The KGB knew about it immediately and warned the office manager that if unofficial use was made of that machine again, they would have to take it out of the country. They are locked up over the weekends in government institutions. Computers are the same way.

What will happen as they begin to move with the PC's? It is causing them dilemmas. They say in some cases they can move with it. You can look to Eastern Europe and you can see an increase in the use of PC's in Eastern Europe. You can see an even greater use of these things now in China. But it does press at the limits and it is going to cause them all kinds of aggravation, and it will certainly not lend itself to the kind of computer hacking that we have become so accustomed to seeing in the West and in Asia.

Without that hacking, they will still be hamstrung in their ability to master computer technology. So it poses, in one of the most facinating ways, the dilemmas that Gorbachev has to face. If he moves ahead this way, he runs into political constraints and he runs the danger of upsetting the conservatives and the police, who worry that this use of computers will get out of control.

Your question is well put. It is going to be one of the fascinating things we are going to have to watch in the future to see how they can do it.

Representative **Fish**. Professor Feshbach.

Mr. **Feshbach**. An interesting story about the purchase of computers: Because of the shortage of hard currency, they purchased a large number of computers from, of all places, Peru. The Peruvians delivered them computers for barter, for reduction in debt, and some trade. However they are not working, so there is a problem.

On the question of communications, here the issue is, of course, of modems and printers. One is to have a printer; the other is to be able to print it out. And if they are primarily in institutions and establishments, there is still some control. The question is whether both the modems and the printers will be available for home purchase or for use by people for whom they were not specifically designed.

The best person on this, of course, is Seymour Goodman of the University of Arizona who is the leading Western specialist on computers in the Soviet Union and East Europe, and he follows this in very great detail. I would say that his expectation is that it is going to improve, but it has a long way to go.

MILITARY POSTURE

Representative **Fish**. Thank you. To go back to you, Mr. Goldman, for a minute, you indicated in your opening remarks that you took exception to some of Secretary Wigg's comments.

Would you like to elaborate on that?

Mr. **Goldman**. He indicated, for example, that the Soviets are continuing to expand in the military realm in terms of being aggressive. I am not a military specialist, but I look at the interaction that is going on as I see it between Gorbachev and the military leadership, and while I would not say that the Soviet Union has turned into a cream puff. Gorbachev is undoubtedly putting pressure on the military.

I certainly see, under Gorbachev, fewer confrontations between the Soviet Union and the United States than we were accustomed to seeing certainly under even Andropov, Gorbachev's mentor. That is not to say again that the Soviet Union can be ignored. I don't want to say that at all, but going back to that analogy of stock and flow again, I feel that the Soviet Union has seemed to become more accommodating—never losing sight of the fact that its interests are antagonistic to ours—than was the case with prior leaders.

TRADE RELATIONS

The same kind of thing I think holds with trade. He indicated that we should be very restrained in dealing with the Soviet Union. My own sense is that we should proceed cautiously, but we should proceed. Mr. Wigg gives the impression that the Soviet Union is in the same old situation, with the same old leadership, the same old aims. I think that is wrong.

I know it is a dangerous thing if the Soviet Union gets into something like GATT or the IMF; they can't be thrown out. But I do have the feeling at least that some of the people responsible now in the Soviet Union are taking these things seriously and are not interested in simply causing disruption. The danger is, or course, what happens if those people are thrown out, as I tend to suggest they might be.

But I think we should try to encourage the Soviets to talk about trade. There are, of course, dangers. For example, I am probably more concerned about what Toshiba did than many people in Washington, because what has not been stressed it seems to me is that the Toshiba sale undermined one of the most important legs of the triad of our defense. It hit probably the most sensitive area, submarine operations. That is one of the most disastrous things that could have happened.

Yet I do see that all too often the Department of Defense hollers that we should not sell the Soviet Union anything because it can be used for military purposes. I am thinking specifically here about an area of trade where we do have a comparative advantage, and that is food processing. But any sophisticated food processor has computer equipment in it.

In the past, the Department of Defense has always argued that the computer equipment could be used—it could be dissembled and it could be used for other purposes. Now, maybe it can. But if we can't sell them food processing equipment, then I think we are really stuck.

U.S. POLICY

Representative **Fish**. That brings me to my last question, with the indulgence of the Chair.

Mr. Goldman has said that the odds are against Gorbachev succeeding. Mr. Feshbach disagrees.

Question: Should the United States help him out? Some argue this is an opportunity for further breakthroughs and real agreements. Others say that we are just helping a failing Communist system and we should allow the crisis to run deeper.

I guess my policy question is what should the United States do? What should our approach be?

Mr. **Becker**. I don't think that there really is terribly much that the United States can do to affect Gorbachev's fortunes, that is to say, his real prospects of retaining and in fact adding to his power in the next few years.

The agreements that we might reach with him might sit well with one or another force in Soviet policies, but it seems to me that the basis for Gorbachev's political success is going to lie essentially in the progress of the domestic program, because that is really the heart of his claim to power and it is the most important issue being debated.

In those terms, I don't see that there is much that the United States can do. I think that when the United States tries to behave in Machiavellian fashion to effect delicate balances of leadership politics, we tend to fall on our face. Our strength is in openness of policy avenues based upon fundamental moral principle, and that is I think the only real direction in which U.S. policy can be successful.

That kind of approach, with an attention to what our national interests are, with a due consideration of what the interests of world peace require, that seems to me the approach one ought to follow.

I think the attempt to shape the balance of forces within the Kremlin is a will-o'-the-wisp and is likely to be counterproductive.

Representative **Fish**. Any other comments?

Mr. **Goldman**. May I respond to that?

I agree basically that we can't determine domestic policy in the Soviet Union, but I do think there is something we can do. I think we have to take him seriously. That doesn't mean that action by the United States will automatically change the votes in the Kremlin.

But I think, for example, when Gorbachev comes here—and I fully expect that he will be here before the end of the year—that we should treat him with respect and dignity, and I think it would be inappropriate to say that everything the man says is just a ploy to disarm us, to confuse us. That goes for arms control; that goes for trade; that goes for human relations.

And I, for example, was quite distressed by the fact that some of the groups that I have worked with, for example having to do with the Refusenik problem, are talking about having a massive demonstration while the man is here. I would have a demonstration before the man is here, but when he is here I would show him respect and encouragement and not try to embarrass him, because that will play at home, and I think that will reduce his credibility.

Representative **Fish**. Thank you, Mr. Chairman.

Representative **Scheuer** [presiding]. Is my colleague satisfied with the way New York members treat each other?

Representative **Fish**. Very satisfied.

Representative **Scheuer**. It has been a marvelous session. I am sure we could all go on all afternoon. I am going to just ask one more question that was prompted by Mr. Becker and Mr. Goldman.

You said there is nothing much that we could do to affect their domestic politics. If Mr. Gorbachev really wants to channel funds out of the military sector and into the domestic sector, wouldn't a less threatening military posture by the United States make it more credible for Mr. Gorbachev to want to do that? And I have to footnote that; a more threatening military posture in the Soviet eyes.

Obviously, our military posture has to meet the realities of the threat out there. There is an enemy out there in a sense, and it has to meet the exigencies of our needs. But taking all that into account, wouldn't some indication that we would be interested in reducing conventional forces, maybe other areas of the variety of nuclear forces, hopefully some modernization in the administration's position on SDI, wouldn't sort of a variety of those elements reduce the feeling in some parts of the Kremlin that we are a threat?

Mr. **Goldman**. Let me respond first. I think you are right. I think again if he can come to the United States or deal with us as an equal and that we can reach agreements which are in our self-interest as well, I think it will certainly increase his credibility in the Kremlin, that this is a man that the world appreciates.

CAN GORBACHEV DELIVER?

But I think ultimately the question still comes down to the fact, can he deliver at home? Agreement with the United States will help him deliver, and that feeds into that. And I think you are right in that sense, but I would not want to say whether that we make a decision this way or not will determine the man's fate. I think agreement with the United States will increase his chances. And to that extent, yes, I think you are absolutely right.

Mr. **Becker**. Congressman Scheuer, I think both sides begin with perceptions of the existence of major threats from the other side. Those threats are affected by their perception of the relative capabilities, and it is also affected by the rhetoric with which these capabilities are discussed.

There has been a good deal of very interesting discussion in the Soviet Union suggesting that the kind of conception we were familiar with in the heyday of the Brezhnev buildup, may be in the process of alteration.

ARMS CONTROL

Now, the test of that reality, whether or not in fact it is happening, is in arms control negotiations. And I suggest, in a continuation of one of the remarks that I made earlier, that one of the major tests is going to be in conventional arms control, when we confront the Soviet Union with a requirement for asymmetrical reductions in order to achieve a real balance of forces in the European theater, and then we will begin to see whether there has been significant change in Soviet perceptions and whether they are prepared in fact to alter their own military requirements in that recognition.

Representative **Scheuer**. Let me thank you all for a very stimulating, very thoughtful panel.

Senator **Proxmire**. I have a couple more questions.

Representative **Scheuer**. Senator, I didn't see you here. I am sorry.

Senator **Proxmire**. I just sneaked back in.

Representative **Scheuer**. I beg your pardon.

PLENUM OF JUNE 1987

Senator **Proxmire** [presiding]. Mr. Feshbach, the proposals made by Gorbachev at the June Party Plenum and the actions taken there seem to have changed many experts' minds about the nature of the reforms and how far they might go.

Can you give us a brief analysis of what was proposed and accomplished by the Plenum, and its significance?

Mr. **Feshbach**. It seems the Plenum of June 1987 really laid the foundation for the major move ahead in reform of policies on the planning system, on prices, on investment, on wholesale trade, on the 11 pieces of legislation which Aganbegyan has said they have actually passed.

PRICE REFORM

Senator **Proxmire**. The figures there are something like 200,000 products that would be priced in the free market, the relatively free market. They would not be priced centrally at any rate, and since a very large proportion of all manufacturing plants would be decentralized, that is the objective.

Mr. **Feshbach**. Yes. But still there are these state orders through which the state probably will still continue to order the production and mix of the most important products.

The reference earlier to the most important products by Secretary Wigg—it is a specific term that the Soviets use. It is not just a series of words. There is a definition of "most important," and there are a series of categories of "especially important," "most important," "important," et cetera, that one does have to look at and there is information on in fact.

Normally they are the high-priority, defense-related and other products which are most important. Those will continue to be controlled centrally, at least so far as we know.

BANKING CREDIT SYSTEM

The banking credit system is to be changed. The government activities, the ministries are to be changed. Talyzin, the head of Gosplan, still is in office, which is very surprising. Until June 1987, when Gorbachev has denounced the State Planning Committee and State Material Technical Supply Committee, that is Gosplan and Gossnab respectively, he never mentioned the name of the boss; that is, of Talyzin and Voronin, respectively. For the first time ever, he did name them. Normally that means pretty soon, goodbye. You volunteer to retire or be transferred at your own request, or whatever the case may be.

RESTRUCTURING OF PLANNING

Nonetheless, they are still in office, 3 months later, which is a little bit surprising. Talyzin, just before the Plenum of May 1987, in their own house organ Planned Economy, their own journal, wrote about the restructuring of planning, almost sort of anticipating what is going to happen.

In addition, there have been some very interesting remarks almost about how they are going to turn things around to still retain the old system. So I am sure it is still playing out, and even though Aganbegyan told Mark D'Anastassio of the Wall Street Journal that it would be published almost immediately after his article in an interview that he had in Moscow, it is still not published. And Zaslavskaya had told us the other day, as well as Aganbegyan, as she told a New York Times reporter before that—she was here at the American Enterprise Institute last week—she said no, it is being shown to the leadership first and not yet issued, even though they have supposedly published 600,000 copies of this. We do not have a single one yet.

PRICE REFORM

Maybe they will throw out the whole issue. That can happen, has happened. But it is supposedly now at the next stage where the Plenum really laid the basis for major changes. I am not sure the price changes will be sufficient. Two hundred thousand products out of 5 million or 50 million products, whatever the number actually is, could be just the edges, but the beginning.

I know they have brought in Bela Csikos-Nagy, who is the former head of the State Committee on Materials and Prices from Hungary to advise them. Not necessarily that they are that successful right now, but that is partly the oil shock and other problems affecting the very high foreign trade proportion of the Hungarian economy, the scale obviously being very different, so it would have much more of an impact in Hungary.

Senator PROXMIRE. You say 200,000 may be part of 5 million or 50 million? You can't give us any more precise or specific notion of how substantial this is?

Mr. FESHBACH. No, because I do not know which sectors it is in. I do not know what the price levels are. I know that prices need to be changed.

I can give you a real example of one which is just unbelievable and one of the contributors, I think, to why they have medical problems. That is the price of an antibiotic, of a particular one, in the Soviet Union, I just found out the other day, is 7 kopeks. Now, that affects how much they spend per day, per patient day in a hospital, which is roughly around $5 or $6, translated into official exchange rates, for a patient in the surgical ward of a cancer hospital. That these are just completely unreal prices is what I am trying to say, not just to bring up the health issue per se, although they have themselves, with a brand new decree on August 15, a draft decree on health which is absolutely remarkable for its candor.

Senator PROXMIRE. We will have to wait a while to see what the significance is.

Mr. **Feshbach**. That is correct, sir. I know they are beginning to do it. Zaslavskaya in her statements the other day seemed really not to be responding to the question about how much they are going to change. I think it is just the start of it. But I think that they are starting, and that is the difference.

I think they are finding it much more complicated than they thought.

ADJUSTING PRODUCTION

Senator **Proxmire**. Mr. Goldman, assuming there is some implementation, and I realize your judgment, which is a very good judgment, a very informed judgment, is that it is unlikely that Gorbachev will succeed in this effort, but if he does, how will the Soviet economic performance change? Will the gross national product take off? Will it maybe do worse? What is your judgment?

Mr. **Goldman**. First of all, it will be a completely different profile than we are used to seeing because it means that you are going to have to, in the short run, scrap not only those 13 percent industries which are losing money, but you are going to have to scrap a good portion of the rest of industry which is producing products which still would not be counted in the future.

I am thinking specifically of the steel industry. The Soviet Union is the world's largest producer of steel, produces twice as much as we do. Granted, we should probably produce more, but they produce too much. They are going to have to close all those things down.

So in the short run, if reform has meaning, they are going to contract, and in the long run presumably they are going to build up brand new industries for consumers, for food, for technology.

Ultimately, if all these reforms really do work, the Soviet Union will indeed become a leading world producer of goods which will enter into the world market and ultimately, because the demand has been so frustrated over the years, presumably there will also be an enormous demand for consumer goods which have been denied the Soviet people.

So I think in the long run, the prospects of economic growth increasing are significant. The trouble is, in the short run there will be such chaos that I don't think Gorbachev will outlast the storm. But I do think that there will be growth and it will be so different from anything we have seen that it is going to be amazing.

ECONOMICS EXCHANGE

Let me just add something to what Murray Feshbach just said about the changes. There is a brand new way of looking at things in the Soviet Union. In the summer when I was visiting the Institute of Gosplan, which I have had difficulty getting to see before, not only did they receive me and receive me warmly, but they proposed an exchange with the Russian Research Center and Harvard University generally. From no contact, now to let's have an exchange; we want to send our people. Why do you want to send your people to Harvard? So we can learn more about market economics.

Now, there are some people who will say that is not the right place to go. [Laughter.]

But the very fact that they are the ones promoting this suggests——

Senator **Proxmire**. It depends on whether they go to the Harvard Business School or go to the Harvard Arts and Sciences.

Mr. **Goldman**. It is Arts and Sciences. They want to learn about market processes.

And Marty Feldstein, for that matter, is there right now in that institute, talking to those people just about this prospect. So they are taking it seriously. Whether or not it is going to get off the ground, I don't know, but if they do, they will indeed show some growth simply because it will be like the United States after World War II. We had this pent-up demand. Suddenly now they are going to provide for the people, and I think that will take off.

OUTLOOK FOR REFORM

Senator **Proxmire**. One final question, and that is for Mr. Becker.

You make the argument in your prepared statement that if the Soviet economic performance begins to show rapid improvement, Gorbachev's reform drive may weaken.

That seems to contradict what some other analysts have said, including some who have been here this morning, that Gorbachev needs some quick successes if he is to retain the authority he needs to move ahead.

Mr. **Becker**. My argument was that if you follow me in believing that what is really uppermost in Gorbachev's mind is modernization and that reform is only instrumental to the achievement of the former goal, then to the degree that he succeeds in propelling modernization along, the need for reform will correspondingly decrease. And if he is not a "born-again" reformer, then it seems to me the zeal with which he pushes that will flag.

If, on the other hand, you believe that even if he began as an "instrumentalist" he has become converted to the necessity of reform as a long-term part of the program, then he may continue that way.

I am posing this as a question, without being able to provide a definitive answer, although I must say that my own predilection is to regard him more as a man who sees the instrumental function of reform rather than as a believer in reform as an end in itself.

Senator **Proxmire**. So the answer is maybe.

Mr. **Becker**. My predilection without a prediction. Let me note one thing with regard to whether or not growth is going to increase. I think it will, but we may find ourselves in the fascinating situation of a measurement dilemma that was characteristic of the problem we had when we were measuring the Stalinist transformation.

MEASURING PRODUCTIVITY GROWTH

You may remember that when we tried to measure what was happening between 1928 and 1937, we ran up against a very difficult index number problem. If you measured the changes in terms of the prices that prevailed at the onset of industrialization, you got one set of growth measurements. If you measured it in terms of the sharply changed prices of 1937, you got a different set, and the numbers varied very smartly.

It may be that if Gorbachev really does succeed in a modernization drive, the structure of output will change in such a fashion that the rate of growth calculated in, say, prices of 1982, the year of Brezhnev's death, and the rate of change in the prices of, say, 1995 will show radically different rates of growth.

Senator PROXMIRE. Mr. Feshbach, I was going to conclude. But if you want to say something, go ahead.

POLITICAL MOMENTUM

Mr. FESHBACH. Please let me very briefly add two political events that happened at the June 1987 Party Plenum on economics that you asked me about a moment ago.

One was he got three more members elected as full members of the Politboro.

The second, very important event is that he did not succeed in January 1987, with his proposal for a party conference to be held next year, 1988. Yet now he has a firm date of June 28, 1988, both of which show momentum and backing by the leadership that will at least allow him to continue.

Again, whether he will be fully successful, partially successful, not successful, is to be seen. But I think that there is still this motion which is very impressive.

Senator PROXMIRE. Thank you very much, gentlemen.

Gentlemen, you have done a superb job. We are very much in your debt. I can't add anything to what Congressman Scheuer has said. You did a great thing for the Congress and for the country in your testimony this morning.

Tomorrow morning, we will have an open session at 10 o'clock. William Colby, former CIA Director, has spent 25 years in the CIA and the last 3 years as Director; Herbert Ellison, University of Washington; and Condoleezza Rice of Stanford University.

[Whereupon, at 12:05 p.m., the subcommittee recessed, to reconvene at 10 a.m., Friday, September 11, 1987.]

ECONOMIC REFORMS IN THE U.S.S.R.

FRIDAY, SEPTEMBER 11, 1987

Congress of the United States,
Subcommittee on National Security Economics
of the Joint Economic Committee,
Washington, DC.

The subcommittee met, pursuant to recess, at 10 a.m., in room SD-562, Dirksen Senate Office Building, Hon. William Proxmire (chairman of the subcommittee) presiding.

Present: Senators Proxmire and Sarbanes; and Representatives Scheuer and Fish.

Also present: Richard F Kaufman, general counsel.

OPENING STATEMENT OF SENATOR PROXMIRE, CHAIRMAN

Senator **Proxmire**. This morning, we continue our inquiry into the economic changes taking place in the Soviet Union.

It is now about 2½ years since Secretary General Gorbachev succeeded to power. There is a good deal of information available to make at least preliminary judgments about his policies, his intentions, and his record of performance. There is also a considerable history about the Soviet Union from which it may be possible to draw lessons.

Among the many questions that we hope to discuss at today's session are the following:

First, what does history tell us about the prospects for reform of the Soviet economic system?

Second, is the Stalinist system being changed in a fundamental way or is it merely being improved?

Third, what are Gorbachev's aims?

Fourth, how will the reforms affect the conduct of foreign policy, including trade and arms control?

And fifth, are the reforms good news or bad news for the United States and the Western Alliance?

We have an outstanding panel of experts to guide us in the search for answers to these and other questions.

William Colby is the former Director of Central Intelligence. He spent 25 years with that agency. He is a veteran, perhaps the outstanding expert in the country on the status and quality and potentiality of our intelligence.

Peter Reddaway is the secretary of the Kennan Institute for Advanced Russian Studies.

Condoleezza Rice is a professor of political science of Stanford University.

Herbert Ellison is unable to make his scheduled appearance because of a sudden illness in his family. Peter Reddaway agreed on very short notice—in fact just yesterday—to substitute for Professor Ellison and to present the prepared statement that Professor Ellison prepared.

Mr. Reddaway, we are most appreciative and grateful to you for agreeing to do this. Of course, your own views will be most welcome.

We have received prepared statements from the scheduled witnesses. I would like each of the panelists to take 10 minutes to summarize their prepared statements so there is a maximum amount of time for questions and answers. The full text of the prepared statement will be included in the record of these proceedings.

Mr. Colby, as I told you at the beginning of this session, I made a statement on the floor of the Senate earlier this week, on Wednesday when we first came back, about the remarkable contribution you have made to arms control and your great record with the CIA for so long. So we are delighted to have you.

I am going to have to leave to go to the floor to make another statement, and I will be back as soon as I can. The chairman of the full committee, Senator Sarbanes, will preside.

Senator SARBANES [presiding]. Mr. Chairman, before the panel begins, I think I ought to register the contribution which I think you have made over the years in holding hearings bearing on the subject of national security economics. In fact, the contributions of the JEC in this area under your leadership have become really an essential part of the literature on the subject matter, and I am very pleased to see this set of hearings that you began yesterday, will hold today, and will continue next week. It only underscores how much is going to have to be done in the next Congress when you are no longer with us. But we appreciate the leadership you have shown.

I think if the panel has not worked out amongst itself how to proceed, why don't we start with you, Ms. Rice, and we will just move right across the panel to Mr. Reddaway and then to Director Colby.

STATEMENT OF CONDOLEEZZA RICE, PROFESSOR, POLITICAL SCIENCE, STANFORD UNIVERSITY

Ms. RICE. Thank you, Mr. Chairman.

I am going to concentrate my remarks, Mr. Chairman, on the impact of the Gorbachev revolution and reforms on Soviet foreign and defense policy.

PERIOD OF EXTRAORDINARY TRANSFORMATION

Quite clearly, the Soviet Union is in a period of extraordinary transformation and flux and Gorbachev has undertaken an extraordinary program, trying to restructure and rejuvenate the Soviet economy, trying to rejuvenate political and cultural life in the Soviet Union and trying to reinvigorate Soviet and foreign defense policy.

The potential impact of these changes in the Soviet Union is certainly great, and it is an important time I think for us to examine both the impact of those changes on the Soviet Union itself and the potential for the United States and the Soviet Union to take advantage of the opportunities that the changes will present for a bettering of the United States-Soviet relationship.

I am going to raise three issues and have raised them in my prepared statement. The first is the nature of Soviet foreign policy under Gorbachev; second, the impact of his reforms on Soviet military power; and finally, just a few words on the opportunities and dangers that may face the United States and American foreign policy as those changes take place.

FOREIGN POLICY

Clearly the primary thrust of the Gorbachev reforms has been in the domestic arena. The economy has been his No. 1 priority since he ascended to the General Secretaryship in March 1985, but because the Soviet Union is a great power, indeed a superpower, Gorbachev has not by any means neglected foreign policy.

The U.S.S.R. has a number of interests, objectives that it must defend, gains that it wishes to protect, and therefore it is important to realize that Soviet objectives, that is, the wish to increase the influence of the Soviet Union in the international system and indeed to create an international system where Soviet political values and institutions dominate, that objective has not changed.

To the degree that Soviet values and political institutions conflict with our own, we can expect continued rivalry and competition with the Soviet Union into the next several decades.

But while the objectives may not have changed in Soviet foreign policy, it is important to realize that the instruments of Soviet foreign policy could change as a result of the Gorbachev revolution.

MILITARY POWER

Gorbachev inherited a very powerful military instrument thanks to the enormous military buildup in the Soviet Union. Particularly between 1965 and 1976, the Soviet Union achieved a number of its objectives for its military power. First and foremost, the Soviet Union arrived as a superpower. Second, it made certain that the Soviet homeland would be secure. And, third, it was able to extend through the application, selectively and cautiously, but nevertheless probing opportunities, the application of that military power into corners of the Third World and to extend the Soviet influence there.

MIDDLE EAST

Nevertheless, from Moscow's vantage point, by the end of the 1970's and the beginning of the 1980's, Soviet foreign policy was in something of a box. It had run aground. The loss of Egypt, even with the acquisition of Syria as a friend, combined with America's Camp David accords, reestablished the United States as the preeminent actor in the Middle East, and not the Soviet Union.

SOUTHEAST ASIA AND LATIN AMERICA

The Soviet Union was a nonactor in many important areas of the world, particularly with the newly industrializing states of Southeast Asia and the large newly industrializing states of Latin America, Brazil, Argentina, and the like.

AFGHANISTAN

The Soviet Union had become mired in a costly war in Afghanistan and with several major powers in the world, the Soviet Union had very little, if any, influence. In fact, post-1978, the relationship with China and the relationship with Japan, the Soviet Union's Asian neighbors, actually began to deteriorate.

NATO

In Europe, the Soviet faced as a result of 1983 and the decision to deploy by the United States and NATO, faced a greater threat from European territory to the Soviet homeland than it had ever faced before; this, in spite of a carefully orchestrated Soviet effort to avoid that deployment.

LIMITS OF MILITARY POWER

The U.S.S.R., it turns out, was really without instruments beyond its military power to shape and influence the course of international events, and I believe, Mr. Chairman, that it is here that Gorbachev differs from his predecessors, that he understands fundamentally that while military power buys a certain kind of respect, indeed fear, that it is very hard to carry out a balanced foreign policy and to achieve all of one's objectives using military power virtually alone.

He has finally learned the lesson that one cannot simultaneously threaten powerful states with extinction and expect them to cooperate economically and technologically.

NEW SOVIET IMAGE

Therefore, I see at the base of the Gorbachev new foreign policy an effort to give the U.S.S.R. broader influence in the world through a rejuvenated economy, an image of the Soviet system as a vital alternative to the Western models, and through skillful diplomacy.

It is my estimation that this is one reason that glasnost', which is primarily a mobilization tool internally, has such a public face to it. It is to give the the American and Western press a glimpse at a rejuvenated Soviet society.

MILITARY POWER

Now, to be sure, Soviet military power has not been neglected and will not be neglected in the Gorbachev reforms, but here we must divide that into the short-term impact of the Gorbachev reforms on military power and the longer term impact.

CURRENT MODERNIZATION PROGRAM

In the short term, the current modernization program of the Soviet military seems to be on track. A report of this very committee about a year ago, which suggested that the 1986–96 current modernization program of the Soviet military would proceed apace, I think is being borne out. We are seeing in the strategic nuclear area the deployment of the Soviet SS-25, their new road-mobile ICBM, expecting the deployment soon of the SS-24, their rail-mobile and silo-based ICBM. Potentially the Blackjack bomber will finally appear, the intercontinental bomber. One more Typhoon submarine has gone to sea.

This has been mirrored in the conventional area where many, many—especially in tactical aircraft—improvements have been made to Soviet air forces.

Nevertheless, there may be—and we do not know this yet—some impact in trying to stretch out Soviet programs, in operations and maintenance, perhaps some demands for conservation of jet fuel and the like which could affect Soviet military training. But the important point is that the current modernization program seems to be proceeding apace.

MEDIUM-TERM OUTLOOK

In the medium term, however, the Soviets face a number of tough decisions about research and development on new systems, about modernization of defense plants, and about which weapons systems to try to speed up and to take into the field. They are reaching a crucial period when in 1988 much of the really important planning for the 12th 5-year plan and resource allocation decisions have to be made. It should reach a crucial stage between 1988 and 1989.

It is, in my estimation, Mr. Chairman, one of the reasons that they are so anxious to stabilize the strategic environment with an arms control agreement so that they know what American systems they are planning against.

But there are other factors that will govern what they do with defense resources in the short term, the performance of the Soviet economy in the meantime. And I should note that the Soviet military, I believe, is not opposed to the modernization program. In fact, while they may have hoped that it would not bring about cuts in the defense budget, any thinking military man knows that the Soviet Union cannot meet the challenges of the 21st century battlefield unless the technological and production base of the Soviet economy improves substantially—and that is the Soviet military literature.

LONG-TERM OUTLOOK

Finally, in the very long term, depending on how successful Gorbachev is at relying on other instruments in foreign policy, we should know what place Soviet military power will really play in the next 20 years or so in Soviet foreign policy. But I do want to emphasize that this is not a man who has neglected the military instrument.

U.S. POLICY

Finally, I would just like to raise a few points about the opportunities and pitfalls that this presents for American foreign policy. The key, I believe, is to take advantage of the Gorbachev reforms for the United States, to take advantage of the flexibility that we have seen with the U.S.S.R. in arms control that is leading probably quite quickly to an INF agreement; one that, while it does not substantially reduce the military threat to NATO, has certainly showed that one can, through a staunch policy as we pursued in 1983, get reasonable agreements.

I believe that there are similarly attractive proposals on the strategic arms table and that we should look at them very seriously. I am more troubled by some of the proposals that are being made in conventional arms. The most important thing there is that the United States and NATO have to get the military planning done to know what it is that we want in conventional force reductions in Europe.

Therefore, I think that we can take advantage of this new flexibility to substantially change the strategic environment and to lower the threat. Nevertheless, there is one pitfall out there, and that is that if the U.S.S.R. does change for a while to a policy based less on military might, I am sanguine that the United States can play on that battlefield very well—or on that playing field very well is perhaps a better allusion.

The United States will always have a more powerful economy and a more vital social system. But authoritarian governments can change the rules of the game very quickly, and if in response to, for instance, instability in Eastern Europe, the Soviets should change from that moderate course, Soviet military power will always be at the disposal of the Soviet leadership.

Therefore, the proper course for the United States, it appears to me, is to take the moderate course and to take the opportunities presented to us by this flexibility, but of course to continue to pay great attention to the modernization of the forces of the United States and NATO.

Thank you.

[The prepared statement of Ms. Rice follows:]

PREPARED STATEMENT OF CONDOLEEZZA RICE

SOVIET FOREIGN AND DEFENSE POLICY UNDER GORBACHEV

Good morning and thank you for this opportunity to address the impact of the Gorbachev reforms on Soviet foreign and military policy. The Soviet Union is in period of transformation and flux. The changes there could be the most revolutionary since the Stalinist transformation of the Soviet system in the 1930s. Gorbachev is seeking to restructure the Soviet economy, to rejuvenate Soviet political and cultural life and to infuse the Soviet Union's foreign policy with new energy and vigor. There are many dangers ahead and we will not be able to judge the success or failure of the effort for many years. Nevertheless, the potential impact on Soviet foreign and military policy is great and the opportunities and dangers that the Gorbachev reforms hold for U.S.-Soviet relations should be examined.

I will raise three issues for you today. (1) The nature of Soviet foreign policy under Gorbachev; (2) The impact of the Gorbachev reforms on Soviet military power; and (3) The opportunities and dangers that the changes in the Soviet Union present for American foreign policy.

Soviet Foreign Policy

The primary thrust of the Gorbachev reforms is in the domestic sphere. Rebuilding the Soviet economy has been his first concern and, more recently, he has attempted to mobilize intellectuals and enlightened workers in support of his goals through reforms in the cultural, and to a lesser extent, political spheres. Gorbachev and his advisers realize that the Soviet people need to believe in the vitality of the Soviet system as a whole if economic reforms, which rely on motivation to work harder, are to be succesful.

Though the domestic arena has been his primary concern, Gorbachev has not neglected foreign policy. The Soviet Union is a great power with interests, objectives and hard won gains to protect. The Soviet Union still wishes to increase its influence in the world and to create an international system where Soviet political values and institutions dominate. To the degree that those values and institutions conflict with our own, the competition with the Soviet Union in the international system will continue whatever the outcome of the Gorbachev reform. In this important sense, Soviet objectives have not changed.

What could change are the instruments that the Soviets employ to achieve their objectives. Gorbachev inherited a powerful military instrument. The extraordinary investment in military power, particularly in the period from 1965-75, has paid off. The Soviet Union has achieved superpower status, the Soviet homeland is itself secure and in the period of the 1970s, the Soviets managed to acquire a number of new friends and clients and to extend their influence deep into Africa and into Central America.

But in spite of these gains, Soviet foreign policy had begun to run aground by the end of the 1970s. The Soviet Union was unable to extend its influence in a number of important regions of the world. The loss of Egypt as an ally in the Middle East left the Soviet Union with no true friends in that region. Only its relationship with Syria, an independent and volatile actor, made the Soviet Union a factor at all in that region. On the other hand, the Camp David process reestablished the United States as the preeminent power with the key ally and friend in Israel and influence with the moderate Arab states. The Soviet Union had no voice at all with most major Latin American states. or with the newly industrializing countries of Southeast Asia the Philippines, South Korea). Only with small, peripheral and very weak states like Ethiopia, Angola and Nicaragua was the Soviet Union able to translate its military power into real influence. Relations with Japan and China actually deteriorated in the late 1970s. And the invasion of Afghanistan brought a quagmire upon the Soviet Union and sullied its image in the Third World. Thus, while the Soviet Union appeared to be "on the move," a hard assessment by Moscow of the gains afforded it by its enormous investment in military power and, more importantly, the potential for further gains may have been quite sobering.

The problem was that the Soviet Union lacked the range of instruments needed for the pursuit of a balanced foreign policy. The Soviet Union's major claim to superpower status was its military power. While military power earned them respect, it could not be used to gain influence with states like China, Japan or the newly industrializing states. They, unlike weaker states of the Third World, did not need or want the Soviet Union's military assistance, Soviet economic power was meager, and Soviet diplomacy was clumsy at best. One of the clearest lessons must have been learned in the INF episode, late in 1983. Here the Soviet Union tried to court the Left in Europe, cajole moderates and threaten the governments of those countries. The policy failed and the NATO deployment began. As a result of the deployment, particularly of the Pershing IIs, the Soviet Union faces a qualitatively new threat to the homeland. Similarly, Soviet threats and the military buildup on the home islands of Japan served only to sour potentially lucrative technological and economic relations and encouraged a warming of American and Japanese ties. The same can be said for the military threat to China which has not produced a softening of the Sino-Soviet split but has contributed to China's pursuit of acommodation with the United States. In short, the Soviet Union learned that it is difficult to translate military power into a foreign policy that can meet the range of objectives and goals that the leadership faces.

It is now a truism that Gorbachev desires "breathing space" and a reduction of international tensions in order to concentrate on his domestic reforms. This is certainly a motivating factor. But I believe that it is only one factor in the "new foreign policy" of the Soviet Union. Gorbachev intends to braoden the base of Soviet power in the world. He intends to give the Soviet Union the ability to influence the international order through a rejuvenated economy, the image of the Soviet system as vital and energetic and through skillful diplomacy. Military power will not be neglected and is still the bedrock of

Soviet foreign policy. But Gorbachev seems to understand what his predecessors did not: One cannot threaten other powerful states with extinction and expect them to engage in beneficial trade and economic relations at the same time. This premise, I believe, is at the core of the Gorbachev "peace offensive." It also explains why he says that the Soviet Union seeks interdependence, mutual security and competition based on other than military power as the basis for a "new foreign policy."

In the short term, skillful diplomacy and glimpses into the revitalization of Soviet society through the Western media will have to bear most of the weight of the "new foreign policy." The transformation of the Soviet economy into a real instrument in international politics is years maybe decades away if it is attainable at all. It is important to Gorbachev that the American press take note of the Soviet Union's cultural and political thaw. The Soviet Union is being polished up and presented to the world as a vital alternative to the Western model.

Soviet Military Power and the Gorbachev Reforms

It is only in this context that one can understand the impact of Gorbachev's policies on the future of Soviet military power. But here it is important to make a distinction between the short and long term impact of the Gorbachev revolution on the Soviet military. I will emphasize the implications in the short and medium term in my remarks because there are too many unknowns to adequately judge very long term trends.

The Soviets have continued to modernize both their conventional and nuclear forces. According to a report of this committee which is consistent with my understanding of Soviet military developments, the modernization program begun in 1986 should reach closure in 1996. The 1986-1996 program is on course. This includes, in the strategic nuclear arena, the deployment of the new road mobile SS-25, the completion of flight testing for the rail mobile and silo based SS-24, the completion of tests for the Blackjack intercontinental range bomber and the deployment of another Typhoon submarine. Similar developments have taken place on the conventional battlefield with upgrades of Soviet mechanized armor, tanks and the Soviet air forces. These deployments represent sunk costs for the Soviet Union and few resources would have been saved by cancelling these programs. Some cost savings may come from stretching out programs or cutting back on operations and maintenance (conservation of jet fuel for training for instance) but this modernization program seems to be proceeding at about the pace that was expected.

On the other hand, the Soviets face some very tough choices in the future. They must decide what resources to allocate to modernization of defense plants, research and development of new weapons systems and how fast to try and deploy new generation weaponry. Much of the planning for the next modernization program under the rubric of the 12th Five Year Plan will reach its crucial stage in 1988. Here decisions about the diversion of resources from the modernization of plants for military hardware to the base of the economy and about the transfer of skilled labor and scarce resources from military programs to both civilian and dual use industries could have a major impact on the Gorbachev economic modernization effort. Three factors are significant in making these choices. First, the Soviet Union must determine the character of the strategic environment and the competition with the United States. The Soviets need a stable strategic environment. They need to know what American programs they will be facing. Basic questions like the character and pace of the Strategic Defense Initiative are critical to the investment decisions that they must make. It is, in my estimation, for this reason that the Soviets are so anxious to achieve a strategic arms control agreement as soon as possible. The INF treaty, which appears close to completion, is a kind of side show, intended to create the conditions and momentum for a strategic arms control treaty or at least for an American pledge, with or without the administration, to slow the pace of the Strategic Defense Initiative.

Second, questions of the devotion of resources to military power in the 12th and the 13th Five Year Plans will rest heavily on whether economic performance improves so that the growth rate can begin to support simultaneously consumer, investment and military spending. It is doubtful that increased growth and productivity are going to be significant enough to allow them to avoid tough choices, but the performance of the economy in the next three to five years will determine how tough some of those choices are. I would like to emphasize that the Gorbachev economic modernization program is not unpopular with the Soviet military. They might hope that there will be no reduction in the defense budget. We do not currently know whether the Soviet military will have to make major sacrifices. But any thinking Soviet military man knows that the weakness of the Soviet economy and its technological base is ultimately a threat to Soviet military power in the 21st century. The battlefield that will be dominated by high technology weaponry and the information processing revolution will not be a comfortable place for the Soviet military if the Soviet economy is not transformed. The Soviet military may be willing to forego some short term military spending if, in the long term, a stronger Soviet economy can support more technologically sophisticated forces.

Finally, in the very long term, Soviet decisions about resource allocation to military programs depend on how successful they are in designing a foreign policy that is less dependent on military power. If the more broadly based Soviet foreign policy that I described becomes a reality, the Soviet Union will be a very tough adversary but one that is less likely to try and transform the international system by force.

Opportunities and Pitfalls for American Policy

The Soviet Union has shown flexibility and a willingess to compromise on arms control issues. We should take advantage of this, as we have recently done in the INF talks. The current framework for an INF agreement, while not without political and military costs, is a net gain for the alliance, reducing, however marginally, the military threat to Europe and demonstrating that the resolve of the alliance in 1983 did bring benefits. In my estimation, attractive proposals are also on the table concerning strategic nuclear forces and we should use this opportunity to reduce the most threatening Soviet systems.

I am more troubled by the proposals that the Soviets put forth at the recent Warsaw Pact meetings on conventional force reductions. Obviously, the opportunity to reduce the offensive potential of the forward deployed Warsaw Pact forces is one that we will not want to lose. But the Soviets could make token reductions in their forces, even removing forces from Eastern Europe, and still present a formidable threat to NATO. The United States must be careful not to create a strategic asymmetry by moving forces back to the United States and then trying to win a mobilization race with the Soviet Union whose forces would be on the continent. Nevertheless, we should engage the Soviets on this issue and we must begin the military planning necessary in our own system to decide what makes sense for NATO and American strategy in Europe and how arms control can help us to achieve a real reduction in the threat.

There is one other pitfall that we may face. If and when the Soviets, even temporarily, appear to be less reliant on their military power, there may be a perception that the competition with the Soviet Union is drawing to a close. If the Soviet Union does, in fact, wish to conduct this competition in spheres other than the military arena, I am very sanguine about the ability of the United States to win it hands down. The United States will always have an economic advantage and a political model that is more attractive than the reformed single party system that the Soviet Union might become.

The only real danger is that we lose sight of how quickly an authoritarian government can change the rules of the game. The Gorbachev strategy could fail or he could modify his course in reponse to, for instance, instability in Eastern Europe. Soviet military power will still be formidable. Moreover, in spite of the "new foreign policy," Soviet military power will always be available to the Soviet leadership. Therefore our best course is a moderate one. We must not behave as if the Gorbachev revolution and the "new foreign policy" are accomplished facts. Rather, we should try to take advantage of the opportunities for threat reduction that the next years may provide while continuing to modernize and pay attention to the military resources of the alliance and of the United States. It is far too soon to demobilize either our forces or our will in hopes that the Gorbachev revolution will reverse 70 years of the Soviet Union's reliance on its military power as its primary instrument in international politics.

Senator **Sarbanes**. Thank you very much.

Mr. Reddaway, please proceed.

STATEMENT OF PETER REDDAWAY, SECRETARY, KENNAN INSTITUTE FOR ADVANCED RUSSIAN STUDIES, ON BEHALF OF HERBERT J. ELLISON, PROFESSOR, UNIVERSITY OF WASHINGTON

HISTORICAL PERSPECTIVE

Mr. **Reddaway**. Thank you, Mr. Chairman.

I will present, as requested by your staff, a short summary of Professor Ellison's 23-page prepared statement entitled "Soviet Economic Reform in Historical Perspective," and in doing that I will use an outline which he provided for me.

I should add at this point that I am in broad agreement with his views. Some slight divergencies which do exist may possibly come out in the question period.

I warn you, if you have not had a chance to read the prepared statement, that it is heavily historical and I personally believe that to be useful. So forgive me if a lot of comments, unlike Ms. Rice's, will be mainly relating to the past.

STRATEGIC CONCERNS

Professor Ellison starts by considering the strategic concerns of the Russian and Soviet leadership from time to time over the last three centuries or so in relation to three major items. One is internal security. The second is external security. And the third is the more nebulous question of the role that Russia and, later, the Soviet Union aspires to play on the world stage.

PAST MODERNIZATION PROGRAMS

The problem, the major problem in these respects which successive vigorous Russian and Soviet leaders have identified—not all of them, but from time to time—has been the weak state of the Russian and, later, the Soviet economy, which has simply by its weakness jeopardized those strategic goals of internal security, external security and playing a major role on the world stage.

Professor Ellison goes through the most notable examples of this, starting with Peter the Great at the turn of the 18th century, who tried to modernize Russia in a crash program, realizing that it had to catch up with the Western world if it was to play a role on the world stage and be secure internally and externally.

The next example he picks out is that of Alexander II, who in the period of, roughly speaking, the 1860's, in the wake of Russia's defeat in the Crimean War in its own backyard, embarked on a somewhat similar program of reforms, above all concerned with the economy; for example, freeing the serfs.

The third example he highlights is that of Stalin who, at the end of the 1920's, launched yet another major crash program of economic transformation, concerned about the backwardness and weakness of the Soviet Union in the wake of World War I and the debilitating civil war of the period 1918–21.

The fourth example, is Mr. Khrushchev in the mid-1950's, who was extremely concerned about the inertia, the stranglehold which the ministries were exerting over the Soviet economy, the lack of innovation in the Soviet economy, and who in a somewhat chaotic way, but nonetheless a vigorous way, tried to reshape Soviet economic institutions and to get the country moving again, above all economically, but also politically.

His final example is, of course, the topic of immediate concern to this hearing, Mr. Gorbachev's efforts to do roughly the same thing in the latter part of the 1980's.

MOTIVATION FOR REFORM

The specific concerns which Professor Ellison picks out as being of prime concern to the present Soviet leadership are as follows, and I will take playing a major role on the world stage first.

The concern nearest to home is the so-called Communist movement and the fact that the Soviet Union has been seen by other Communist governments and regimes to be increasingly lagging behind economically and providing a poor example to the rest of the Communist world. In particular, the present Soviet leadership has been stimulated into action on economic reform by the rather radical reforms of the Chinese leadership in recent years.

Second, there is the question of the Soviet appeal to the Third World which has been becoming increasingly weak with the passage of time, as the weaknesses of the Soviet economy become more and more apparent.

Third, there is the question of being taken seriously as a superpower by the United States and other major Western powers. That concern has been growing as the West, too, has become increasingly knowledgeable about the weaknesses of the Soviet economy.

Fourth, on the security side, there is the obvious concern that just pumping money into Soviet arms programs may not be enough; that if there is not sufficient organic innovation within the Soviet economy, the Soviet Union will fall behind eventually in the arms race, and the basic way to cure that problem, which is already an actual problem, is to deal fundamentally with the Soviet economy.

Fifth, as regards internal security, there is the problem that if the Soviet economy continues to perform poorly and perhaps increasingly poorly without drastic remedies, then the internal security of the regime will ultimately be threatened. The citizens will become increasingly disaffected.

HISTORY OF ECONOMIC ORGANIZATION

Professor Ellison gives us a quick survey of the way in which the Soviet economy has been organized from the beginning of the Soviet period, the period of war communism in which the young Soviet state seized the commanding heights of the Soviet economy and bullied the peasants to give up their grain. This produced a revolt in the peasantry and in the working class and led to Lenin's introduction in 1921 of the new economic policy with very considerable freedom for the peasantry in agriculture and relaxation in the light industry field, with less state control.

However, that went into drastic reverse in the late 1920's under the Stalin revolution, and the state seized control, de facto, of the entire economy.

The post-Stalin period saw a number of attempts at reform but most of them, in Professor Ellison's view, have shown a concern to try to streamline and remove some of the worst anomalies of the so-called command economy constructed by Stalin, to improve the administration, to introduce new technology, to improve living standards, but not to deal with the economy in more fundamental ways.

There was an effort made under Mr. Khrushchev to try to initiate reform in that direction but it was brought to an end in the Brezhnev period.

GORBACHEV IN PERSPECTIVE

In the next section, Professor Ellison discusses how, in the light of the last 2½ years under Mr. Gorbachev, the present Kremlin leadership has been orienting itself, on economic policy in particular, in relation to previous periods in Soviet history that I have just briefly mentioned. And he points out that in the debate in the Soviet press and in Soviet political forums, the attitude of the present leadership has been positive toward the new economic policy period, the 1920's, and toward the Khrushchev period, and it has been on the other side negative toward the Stalin period and the Brezhnev period.

He sees in these general attitudes some clues as to the policy directions which the present leaders are likely to take as they search for a viable model for economic reform and a reform strategy in the present period.

DEBATE OVER THE COMMAND ECONOMY

He then proceeds to review some of the major features of the current debate within the political elite and within the so-called creative intelligentsia and Soviet media, and he points out that there are three really important questions about the command economy system inherited from the Stalin period which are being debated.

First of all, why was this particular Stalinist model chosen at the end of the 1920's? How well or badly has it worked over the long period that it has been in effect? And what reforms to that system are now needed?

He points out that this debate faces enormous problems because it is extremely hard to get at the truth, to get the basic data, first of all because Soviet historiography on these issues is extremely faulty and extremely deceptive and misleading, for reasons which are ultimately political. History has constantly been reinterpreted in the interests of successive leadership, and the truth is very hard to get at.

Even though some people may be able to get at the truth, the second reason why this whole process is difficult is that there are very powerful vested interests in the Soviet Union: the conservative intellectuals, the people who staff the ministries and many party organizations, who are very much concerned that the truth not be got at because they are afraid that to the extent that the truth is got at, this will lead to possibly radical changes in the present state of affairs, which will lead to a reduction in their political power and influence.

Nonetheless, despite these problems, Professor Ellison points out that the debate is a very lively one and some fairly startling views are currently being expressed in the Soviet media. He also points out that getting a decent answer to the third question—what reforms are now needed—depends absolutely on dealing seriously with the first two questions: Why did the Stalinist command economy come into existence and how did it work? Where did it work well, where did it work badly, and why?

FUNDAMENTAL REFORM

On this last question, he goes in some detail into some aspects of the debate as to what reforms are now needed and he points out that the main thrust of this debate is between two sides, one of which believes that fundamental reform is essential and that half measures are not going to work, and on the other side, those participants who believe that the leaders should limit themselves to a process of refining the present system.

Going into this in more detail, he points out that the debate is not, at any rate as yet, over questions of public or communal ownership. The central question is the Stalin command economy structure which has denied autonomy to Socialist farms and factories, has repudiated the market, and severely curtailed individual economic initiative. And on this issue, there is furious argument pro and con this command economy structure.

OUTLOOK FOR REFORM

The evidence to date in Professor Ellison's view suggests that Mr. Gorbachev so far is not going outside the traditional command economy structure. He brings examples, particularly the law on the state enterprise which was adopted a couple of months ago, which he regards as disappointing for those people who would like to proceed toward a market system, and also other reforms such as the reform on joint economic ventures with foreign capitalists firms which he also regards as disappointing.

On the other hand, he points out that the liberal intelligentsia is indeed racing ahead with the ideas and arguments that it is putting forward in the media debate, although one should point out that this debate is extremely confused. The proponents of radical reform are far from being united among themselves.

The final question he poses is whether Mr. Gorbachev and his colleagues are capable ultimately, in the next year or two, of providing a scheme of fundamental reforms, and second, a strategy for introducing and realizing such a scheme.

On the one side, Mr. Gorbachev's own vigorous leadership, his growing power in the party apparatus, and this lively intellectual debate in the media and in party forums he regards as encouraging signs for more fundamental reform. On the other side, however, he believes that the limits revealed in Mr. Gorbachev's ideas to date and also the heavy resistance to his various reform initiatives from the status quo groups within the ministerial and party structures, and also within some sections of the intelligentsia, are not encouraging signs. So he leaves his options open.

Thank you.

[The prepared statement of Mr. Ellison follows:]

PREPARED STATEMENT OF HERBERT J. ELLISON

SOVIET ECONOMIC REFORM IN HISTORICAL PERSPECTIVE

THE ECONOMICS OF RUSSIAN AND SOVIET POWER

When Secretary Gorbachev tells his countrymen that failure to deal with the mounting problems of the economy could mean a decline of Soviet power, his remarks recall similar concerns of earlier Russian rulers and the reform programs they inspired: Peter the Great and his program of economic and military modernization undertaken nearly three hundred years ago; the broad reform program of Alexander II that followed Russia's humiliation in the Crimean War; and Stalin's dire warnings about the costs of Russia's backwardness as he launched the First Five-Year Plan of 1928-32. In each case the leader made a close connection between economic and military power, since Western economic superiority was the foundation of the military superiority which alternately threatened Russian territorial security and challenged or frustrated Russian imperial expansion.

Russia's military power _vis-a-vis_ her neighbors and rivals has depended historically upon the size of her population and the general level of her economic development. From the tsars to the

Soviet leaders there is a long tradition of vigorous initiatives by the central government to borrow from the example and the resources of the West to modernize the Russian economy, and with it the military technology required for defense and expansion. Thus did Peter the Great and his imperial successors of the eighteenth century expand the Russian economy and military power so that, in the wake of Napoleon's defeat, Russia was the greatest power on the Continent. But the second half of the nineteenth century witnessed the unification of Germany; with her rapid rise to the position of the most advanced and powerful of the European industrial states. Germany eventually became a dangerous threat to Russia, challenging her severely in two great wars.

The industrial and military expansion of the Soviet period, and the victory in World War II, changed the Russian power position dramatically, and the industrial expansion of the postwar era further strengthened that impressive power. But Gorbachev is right to note a disturbing pattern of economic development, within the Soviet Union and outside, that suggests a recent decline in the relative economic strength of his country that has major implications for the future.

The internal element is a combination of economic and demographic developments. Soviet economic growth was very rapid from the beginning of the plan era through the early 1960s, though interrupted by World War II. But by the late 60s and 70s the annual growth rates showed a steady decline, coming close to zero growth by the beginning of the 80s. The growth decline had come at a point far below the development level of the advanced industrial states, and when the technological level of the Soviet economy was much below those states and was newly challenged by the rapidly advancing newly industrialized countries of East Asia and Latin America. Meanwhile, the population growth of the European portions of the country--the most important industrially--had either reached or approached zero growth, creating a growing problem of labor shortage in an economic system which was short of investment capital, backward technologically and resistant to technological innovation, and inefficient in its use of labor, capital and raw materials.

Many important conclusions could be drawn from such trends. In addition to the general question of Soviet power, there were more specific concerns: Soviet prestige and leadership in the international communist movement, where the economic reform leadership was in the hands of the East European reform leaders or the Chinese; and Soviet prestige in the Third World, where wide knowledge of Soviet economic deficiencies had already greatly reduced respect for the Soviet economic "model".[1]
And there was more at stake: the internal economic pressures raised grave doubts about the feasibility of the massive Soviet arms expenditure and questions about the scope and aims of Soviet

foreign policy; and the continued shortcomings of the economy had serious implications for the morale of the Soviet population.

ECONOMIC POLICY AND ECONOMIC REFORM: A CAPSULE HISTORY

From the beginning of their power Soviet leaders have claimed that socialism would be the foundation of an historically unprecedented economic growth and prosperity. Their ideological bias prevented them giving much credit to the tsarist government for its comprehensive social and economic reforms of the period from the Emancipation of the Serfs in 1861 to the Stolypin agrarian reforms of 1906 and after. That government had played a major role in building the foundation of a powerful modern industrial and agricultural economy, the latter based on small peasant proprietorship. Lenin's victory in 1917 brought total repudiation of the organizational principles of the existing economic system, and its replacement by nationalization of land, industry, transportation, trade and finance. Like other Marxists Lenin regarded it as axiomatic that the socialist system would be more productive than the capitalist.

To place the present phase of economic reform in historical perspective it is helpful to recall the main historical phases of development of the socialist economic system: 1) the first phase (1917-20), usually labeled "War Communism", in which land, industry, banking and trade were mostly nationalizeed and during which the first efforts were made to create socialist farms; 2) the New Economic Policy (1921-28), in which the main campaign for socialist farming was suspended and small peasant farming accepted, and when much small-scale private industry and commerce returned as well, but the bulk of industry (84%) continued to be state-owned and managed; and 3), the Stalin "revolution" which began with the First Five-Year Plan in 1928 and created the basic system which continues to the present day, the so-called "command economy". That system meant the forced collectivization of agriculture, the elimination of private production and trade in the urban industrial and service economies, and the monopoly by party and state agencies of the process of planning and development of the economy.

Stalin's successors through Gorbachev (it is too early to say whether the generalization will eventually apply to Gorbachev) have applied a wide range of reforms to the system they inherited from Stalin--and have tolerated an even wider range of reform in Eastern Europe--but the reforms at home have aimed to improve, not discard, the Stalin system of central planning and management. The focus has been upon improvements in the Party and state apparatus for management of the economy and upon introduction of more advanced technology, usually by importation. Both leaders also gave a much higher priority than Stalin to meeting the citizen's need for improved housing, food and consumer goods, though the enormous expansion of military expenditure during the Brezhnev years severely retarded such efforts. Moreover, both Khrushchev and Brezhnev continued the policy of consolidation of the collective farms into ever larger units and Brezhnev introduced (1966) the system of fixed wages which sought to reduce the peasant's dependence on income from the private plot and expand the share of socialist economy in total agricultural production. Both men also sought to remove the large inequalities in income which had been encouraged from the Stalin era forward and which conflicted so sharply with socialist aims of income equality.

In the main, then, the policy was one of in-system reform.[8] Khrushchev allowed discussion and even cautious implementation of reforms with somewhat larger implications, especially the Lieberman-inspired scheme for greater autonomy for enteprises and the fascinating Khudenko experiment with reorganization of socialist farming. The essence of both schemes was that they aimed to give the manager a more independent say in everything from production planning and investment to the management of the labor force, and they therefore challenged the established system of central planning and control. But the Party rejected both schemes soon after Khrushchev's removal in 1964, just as it eventually rejected his 1961 reform of the Party Rules, a plan which was doubtless inspired in part by his understanding that significant reform of the economic system was impossible without reform of the Party organization.[3]

It is precisely such initiatives that have made Khrushchev something of a hero of the Gorbachev reform era. Every Soviet leadership has established its identity by its view of Soviet history, a habit which provides an important clue to its policy aims and intentions, and the Gorbachev era is no exception. Brezhnev is given very negative reviews, and not the least of his sins was that he scotched the Khrushchev reform program. Thus the man who became an unperson under Brezhnev has been restored to prominence. Conversely, Stalin, the object of two major programs of "de-Stalinization" under Khrushchev, and whose image and reputation were much refurbished by Brezhnev, is again under attack.[4] A third historical element important to the Gorbachev reform orientation is the lively interest in the era of the New Economic Policy as a policy period to be studied for inspiration for new reform initiatives. There is little doubt that these themes are immensely popular among the intelligentsia, and greatly feared by Party conservatives. Their fulsome development under the license provided by glasnost' is encouraged by Gorbachev to provide historical legitimacy for his reform program. At the same time they suggest the broad outlines of his reform objectives.

The exploration of the roots of past policy and its consequences which has revived so vigorously under Gorbachev's *glasnost'* is a process with enormous implications for the course and future of economic reform. At the moment it is still rather general and limited, but already the implications in official statements are important ones. One starts with the general proposition--widely repeated by such prominent reformers as Abel Agabegnyan--that the general structure of economic policy remains that of the Stalin era and that it is inappropriate to present conditions and needs. Aganbegyan describes the need for a "new economic mechanism."[5]

At this point the discussion goes simultaneously backward and foreward in Soviet history. The discussion of the 20s--of the NEP--implies that something important and relevant to contemporary economic needs was lost in the transition from the NEP to the Stalin plan era. This inquiry raises many questions about the relevance of NEP toleration of private industry and trade, and independent peasant farms, to present policy, and more broadly about the possibility of a more pragmatic and gradualist approach to the building of a socialist economy. It is not an insignificant fact that the new editors of the influential jouranl *Novy mir* is much preoccupied with the NEP era and has described the policy of that time as "a strategy of socialism."[6]

The negative tone of remarks about the Stalin era is equally important. The judgement of economic policy remains fairly neutral, in that the emphasis is mainly on the need for a policy appropriate to a new time. But much more is being said: not only the revival of interest in the NEP and the implicit revision of judgements of that era in the Stalinist historiography, and the literary and cinematic return to powerful criticism of the costs of Stalin's rule, but also the positive presentation of the Khrushchev reform efforts and the negative view of their abandonment under Brezhnev.[7]

Underlying this inquiry and commentary, with contributions from many areas of Soviet intellectual and political life, are three basic questions: 1) how the present economic system came into existence; 2) how it has functioned; and 3) what past experience indicates about the needs and prospects of present and future reform. Exploring these questions, without knowing, of course, how far the Soviet inquiry will be able to proceed, provides clues about what to watch in the Soviet discussion, and to the immense significance and political sensitivity of the inquiry.

HOW WE GOT HERE: FROM THE NEP TO STALIN

The question of how the present Soviet economic system developed under Stalin is highly relevant to contemporary reform discussion. Without a thorough and open exploration of the subject it will never be possible fully to understand--or to correct--its deficiencies. And yet it is still an immensely difficult question to explore in the Soviet Union. The truth is shielded from view by a vast body of official historiography whose basic structure was contrived in the Stalin era to present the decisions which launched the plan era--and the Stalin model of economy--as the inevitable product of broad economic and social forces which brought its inevitable victory. What happened in fact is that the Stalin leadership used its monopoly of power, acquired over the course of the 20s, to extinguish all criticism of its planned changes and then used the powerful instrument of the Party and its coercive instruments to impose its economic system: forced collectivization of agriculture[*] and total state management and control of the urban economy within a system based on monopoly central management of decisions on production, investment and distribution. Stalin's initiative ignored the experience of War Communism and of the NEP which had been carefully evaluated by educated and economically sophisticated members of the party. He ignored or misrepresented his critics and even destroyed the lives of many of them.

The loss was simply incalculable. Many of the best economic minds in Russia--a country with a brilliant tradition of scholarship in economics--had labored for years to understand the impact of early socialist experiments under War Communism, and to analyze the development of industry and agriculture under NEP in order to avoid repetition of the costly mistakes of rapid socialization during the early years of Soviet power.[*] Their conclusions--best understood by such prominent party leaders as Nikolai Bukharin--indicated the precise opposite of Stalin's course: long-term retention of much peasant smallholding with only voluntary socialization; a careful balance between light and heavy industrial development with close attention to the needs of consumers; efforts to improve the operations of existing state industries, which had shown many weaknesses as an organizational form, rather than a headlong rush into expansion. It is more than coincidence that the program that Bukharin and others proposed bears a close similarity to those of the reformed communist economic systems of post-Stalin Eastern Europe, and of contemporary China.[10] And it is indicative of the thinking of many among the contemporary Soviet reformers that they suggest that much can be learned for contemporary reform by examining the experience of the New Economic Policy era. Perhaps we shall soon see in Soviet historiography a return to the vigorous inquiry into the crucial period of policy shift in 1928-29 which was abruptly suspended in the early 60s.

THE STALIN ECONOMY: DOES IT WORK?

Raising the second question--how the system has worked--it is interesting to recall Bukharin's prophetic words about the probable outcome of the Stalin policy: "bloodshed, famine, and an economy of perpetual scarcity." The bloodshed and famine that came from the forced collectivization of agriculture are a sadly familiar story, and one that has recently received a thorough historical study. In the sixty years since the collectivization decision there have been many changes in the system of socialist farming, but there is a depressing continuity in fundamental features of its performance: a consistently inadequate output (the world's leading grain exporter has become its leading importer), and persistent shortages of quantity, quality and variety of virtually all food products, not to mention the agricultural products required by Soviet industry. Moreover, even with its poor performance Soviet agriculture requires a huge and disproportionate share (between 25 and 30% annually) of gross new capital investment, aggravating a severe shortage of investment capital in other areas of the economy. Perhaps saddest of all is the depressing picture of life in the villages which emerged first in the 60s and 70s in Soviet literature and has, under Gorbachev, come increasingly from Soviet journalism. Meanwhile, in spite of major efforts to improve living cnditions in the villages the exodus of population--particularly the youngest and ablest elements--continues at a rapid rate.

The Soviets are faced today with the fact that the Stalin economic system has been at least partly abandoned in many communist countries--the most significant recent case being China--and that it is under widecritical review. The Soviets own emphasis upon a reevaluation of NEP, their revival of discussion of the aborted reforms of Khrushchev, their candid journalistic reportage on the conditions in the villages, and their discussion of the challenge of the economic achievements both of the advanced industrial states and of the NICs all provide important indications of their present outlook.

Criticism of the operation of the Stalin command economy is not new. The themes of Soviet criticism of the operation of the urban economy have been repeated since the beginning of the plan era: the low quality and high cost of industrial products; the low priority of consumer goods and housing; the failure to develop or borrow new production technology; the very low level of efficiency of use of capital, labor and raw materials; the long delays and cost overruns in construction projects; the backwardness of the transportation system, and much else. A common counter-argument to these observations is to stress the backwardness of the Soviet economy at the beginning of the plan era and the impressive scale of its growth. But the industrial expansion of the plan era began almost sixty years ago from a sizable industrial base inherited from the prerevolutionary era. Meanwhile, key indicators of economic performance--efficiency of production, adoption of new technology, and general living standards--show a growing gap not only between the Soviet Union and the older industrial states, and between the Soviet Union and Japan which entered the industrial era at the same time as Russia, but a worrying decline vis-a-vis some of the major newly industrializing states of Asia and Latin America. As this is a relative decline which the Soviets share with the other states of the CMEA group, all of which adopted most of the features of the Stalin command economy, the conclusion seems clear that the system is at fault.

WHAT SCOPE OF REFORM?

Before exploring the question of barriers to reform of the Soviet economic system it is useful to distinguish between individual and systemic failure. Doubtless in the Soviet, as in any other economic system, there are ample failures of individual competence and commitment. For this the endless hortatory articles in the Soviet press, and the removals of managers with extensive publicity concerning their failures, are a useful corrective instrument. But such measures have little effect where the problem is one of economic structure--and that has been the case with most of the Soviet economic system over the entire period since the beginning of the plan era. A manager of an industrial plant cannot be expected to produce efficiently the kind and quality of products which his consumers want and require if there is no real incentive for him to do so. If his sole responsibility is to planners and economic administrators, and if there are no penalties for wasteful use of capital, labor and raw materials, he will produce a poor product, and often an unneeded product, at unduly high cost, satisfying administrative quotas and even earning production bonuses.

Reform in the more advanced economies of Eastern Europe, and the serious reform initiatives in the Soviet Union since the 60s, have sought to decentralize and "de-bureaucratize" economic management, giving the manager of factory or farm greater independence in deciding what he will produce and how he will combine available resources and labor to produce it, to whom and at what price he will sell it, and holding him responsible for interest on borrowed capital and for maintaining a profitable operation. In the Soviet case this was the motivation of the Lieberman proposals of the early 60s which became the ill-fated Kosygin industrial reforms somewhat later. The same rationale also underlay the Khudenko experiment in agriculture.[11]

Such reform, the most difficult to achieve, can be described as genuine "systemic" reform in the sense that it is a significant departure from the established system of total central control of planning and management. In its complete form--what has been called market socialism--the decisions on production and sale would pass to the factory and farm managers and their prices would be set on the market. Needless to say, such a change would constitute nothing less than a revolutionary departure from the Stalinist command economy system. It would remove from the hands of the Communist Party and the state economic administrative apparatus which it controls the power to direct production and distribution in the national economy.

BARRIERS TO REFORM

What are the barriers to implementation of such a reform scheme? The experience of the Khrushchev era suggests that there is powerful resistance in the existing bureaucratic structure to a change of the system. Economic administrators guarded their role and powers jealously, and factory and farm managers were often reluctant to change a system in which their responsibity was limited to meeting a production quota and more complex responsibilities were avoided. The brutal treatment meted out to Khudenko ilustrates how dangerous it could be to challenge the position and powers of the established managerial bureaucracy in agriculture. Khrushchev recognized the seriousness of such problems and therefore sought his reform of the Party rules as a means of getting a more effective leadership of the Party apparatus for reform purposes.

The brief period of the Gorbachev leadership, which is marked by a more conscious and comprehensive reform progrm than that of Khrushchev, suggests that Secretary Gorbachev and his closest collaborators have learned their history lessons well. In the first instance, Gorbachev recognizes, as Khrushchev did not, the vital importance of control of the Party apparatus to protect himself and his policies from the Khrushchev fate.[18] He has proceeded with impressive persistence and skill to strengthen his position in the Party organization. In the economic sphere, as in cultural policy, foreign policy, and other vital areas, Gorbachev has also put in place an impressive group of senior administrators who support the reform course.

Another major achievement has been the building of close ties with the intelligentsia--from talented technical specialists to the Soviet litterati--to help him both in the definition and the defense of his reform policy. This effort has been combined with the now internationally famous program of *glasnost'* which has combined candor about contemporary economic failings with increasing candor about the historical failures of Stalin which have considerably eroded the claims which justify the Stalin economic system. It is another large step (and here again the Khrushchev experience suggests cautious expectations) to the formulation and implementation of an effective reform program, a process that has only begun.

WHITHER GORBACHEV?

General Secretary Gorbachev refers to his economic policies not as "reforms" (*reformy*), but as a "reorganization" (*perestroika*). Soviet leaders avoid applying the term reform to proposed changes in their economic system, perhaps partly because Lenin made the term "reformism" into a political epithet in his prerevolutionary polemics with rival socialists. "Reformism" became then--and remains today in the communist world--a term for futile efforts to make a doomed capitalist economic system workable by cumulative, modest improvements in the laborer's income and working conditions, especially by the use of unionization and labor strikes. The term therefore implies patch-up efforts applied to a doomed system--scarcely the image Mr. Gorbachev would wish to convey in describing his own program.

Another and more important reason for avoiding the term is that Soviet leaders see themselves as the heirs of a great revolution and of the wholly new system of society, economy and culture to which it gave rise. They have preferred to view their task as one of completing particular economic and social changes which are part of a still incomplete revolutionary transformation (e.g., Khrushchev's emphasis upon moving from the collective farm with its cooperative ownership and private plots to the state farm on which the peasant became a hired worker on state land), or of pressing forward with such major tasks as the extension of education or the expansion of the scale and production of the industrial economy. Deficiencies of society and economy have conventionally been attributed to "survivals of the past" (perezhitki proshlogo), to bureaucratism, or to a variety of specific failures of responsible administrators.

It is clear, however, that perestroika, if it is to succeed, must change a fundamental economic system--the Stalin system of command economy--whatever the name used for the measures used to accomplish that objective. It is surely too early to judge the Gorbachev policies by this crucial measure, and if it were so judged it would fail.

Gorbachev's early efforts were limited to personnel changes and efforts to restore labor discipline and the development of a program to restructure the system of economic management to give greater independence to enterprises and their managers. Already in early 1986 he acknowledged that opposition to his reforms came from every segment of society--the economic bureaucracy, the industrial managers, and the workers.[13] His schemes promised rewards for the diligent manager and the productive worker, but they also threatened the security and the perks of those grown comfortable with the old order. Especially worrisomne was the wide evidence of worker dissatisfaction.[14]

It was this early resistance that motivated a turn to a broader range of instruments than simple economic reorganization: political "democratization" and widespread use of candid discussion of the current and past failures of the economy At the present time (the summer of 1987) the process of reform shows an interesting and often contradictory mix of developments which support no confident predictions about the future. Perhaps most promising for future reform is the continued consolidation of Gorbachev's power in the Party apparatus--particularly the personnel changes at the June 1987 Plenum and the promise of a Party conference in 1988. Unlike Khrushchev, Gorbachev has shown immense skill in the building of his Party power base.

Other measures were less encouraging. What serious improvement will result will result from regrouping the 37,000 industrial enterprises currently directed by Moscow ministries into East German-style trusts is by no means clear. And the new Law on the State Enterprise, while ostensibly aimed at a providing a new autonomy for the enterprise, is an effort to reconcile retention of central control with encouragement of local initiative--not a very promising blend.[10] The measures taken to encourage foreign investment--distinctly reminiscent of NEP--also founder on the pressure to retain the requirement of majority Soviet ownership and other cautious limitations. What is left are modest concessions to individual peasant economic activity and small-scale enterprise in the service economy.

Thus the Gorbachev reforms--at this early date--are more potential than actual so far as system change is concerned. But it would be wrong to dismiss their continuing promise. Placing them in historical perspective highlights some important advantages for the cause of future reform. There is the immense advantage of an extraordinarly talented, committed and skilfull leader, and an impressive company of newly appointed administrators and analysts. There is the advantage of growing control of the Party apparatus, albeit against continuing conservative resistance. There is the advantage of timing: the urgent need for reform is apparent, and Gorbachev's *glasnost'* makes it more so, even as it permits an open and serious search for reform ideas and employs the creative talent of the Soviet intelligentsia. These are not small advantages, even in the face of so overwhelming a task.

1. It is a widely held view, both among East European intellectuals and among Western specialists on Eastern Europe that Gorbachev is not prepared to move as far with reform as some East European countries have already gone, and that he is very much a reformer "within system." On the relationship of Gorbachev's *perestroika* to East European change see Charles Gati, "Gorbachev and Eastern Europe," *Foreign Affairs*, Summer 1987, pp. 958-75. Gati asserts that "some of these countries have already gone far beyond his *perestroika*..." (p 970)

Kevin Devlin provides a very interesting summary of the comments on the relationship of East European economic reform to Gorbachev's efforts by the Czech exile Antonin Liehm in "A Reformer and his Empire: A Czechoslovak Exile on Gorbachev," *Radio Free Europe Research*, July 10, 1987.

For a recent brief summary of the contrast between Chinese and Soviet reform see Christopher S. Wren, "Comparing Two Communist Paths to Reform," *New York Times*, Section 4, p. 2, September 6, 1987.

2. There were many efforts during the Brezhnev years to introduce changes such as land rentals which broke sharply with previous practice, and to that degree were not part of the familiar "system" (See J. Wylkczynski, "Towrds Rationality in Land Economics Under Central Planning," *The Economics Journal*, September 1969, pp. 544-5). As indicated further in the text (p. 15) my definition of the system is that of planning, production and distribution. Charges of interest on capital or rent on land do not modify that system. To this extent, at least, a Soviet scholar is correct in saying that "These payments have nothing in common with the land rentals that existed in our country before the Revolution..." (V. P. Efimov, *Sotsialisticheskaia intensifikatsiia: sushnost', faktory, effektivnost'*, Moscow, 1971, p. 259.

3. The new head of the Central Committee Institute of Marxism-Leninism, Georgii Smirnov, has recently linked the reversal of Khrushchev's Party reform efforts to the failure of subseqwuent economic reform, showing an appreciation of the close link between Party reform and economic reform which the Gorbachev leadership has identified. Georgii Smirnov, "Revolyutsionnaia sut' obnovleniya," Pravda, March 13, 1987.

4. The initiative in the renewed criticism of Stalin was taken by members of the Soviet intelligentsia, but their attacks were allowed high visibility. Thus Evgenii Evtushenko's poem "Kabychagonivyshlisty", criticizing censorship and Stalin's agricultural collectivization and the persecution of cybernetics and genetics was published in Pravda (September 9, 1985, p. 3). The destructive impact of Stalin's policies in the sciences was given much attention by Literaturnaya gazeta in late 1985.

The call for rehabilitation of old Bolsheviks purged by Stalin was another theme of the anti-Stalin revival (Vera Tolz. "Soviet Historian Calls for Rehabilitation of Old Bolsheviks," Radio Liberty Research, March 6. 1987), as was criticism of Stalin's role in World War II (Claud Bell. "Reevaluating Stlin's Role as Wartime Leader," Radio Liberty Research. August 3, 1987. It is clear that the criticism of Stalin is gaining in scope and severity in recent months.

5. See interview with Abel Aganbegyan in Ogonek, No. 29, July 1987, p. 2. This extraordinarily candid and informative interview appeared in two parts (No. 29 & No. 30).

6. Sergei Zalygin was appointed editor of Novy mir in August 1986. His novel Posle buri (After the Storm) met many difficulties in publication. It deals with the Nep era, and presents the life of that time in a very positive light.

7. In connection with the revival of interest in the NEP, one of the most interesting and important issues is the treatment of Nikolai Bukharin and his ideas. There were many signs in early 1987 of a movement toward unofficial rehabilitation of Bukharin--the man whose opposed Stalin's main scheme for collectivization and industrialization and stood, as Leonard Schapiro has written, for an early-day version of "socialism with a human face." The most striking recent development has been the article by Fedor Burlatsky, the distinguished journalist, which is in the form of a one-act play and was published in Literaturnaya gazeta on July 22, 1987. It is a thoroughly sympathetic portrayal of the ideas of ~~Bukharin~~ which leaves the impression that he was right and Stalin wrong.

8. The best available study of the costs of Stalin's agricultural collectivization is the recent book by Robert Conquest, Harvest of Sorrow: Soviet Collectivization and the Terror-Famine,

Oxford University Press, New York, 1986. Reading this book makes it easy to understand to powerful impulse among many Soviet intellectuals to have the Stalin record fully documented.

9. Many of these scholars were among the so-called neo-populist economists who had considerable influence on the thinking of Nikolai Bukharin (See Herbert J. Ellison, "The Socialist Revolutionaries," *Problems of Communism*, November/December 1967, pp. 7-9). There is also a summary of Bukharin's views in the late-1920s exchanges with Stalin in Herbert J. Ellison, "The Decision to Collectivize Agriculture," *Slavic Review*, Vol. XX, No. 2, April 1961, pp. 198-202.

10. It is interesting that in the early post-Stalin years there was much interest in the NEP era and Bukharin in Eastern Europe, especially Poland. That interest has been duplicated in post-Mao China.

11. The best available study of the reforms of the Khrushchev era is Alexander Yanov, *The Drama of the Soviet 1960s: A Lost Reform*, Research Study Series No. 56, Berkeley, Institute of International Studies, University of California, 1984.

12. Gorbachev has shown immense skill and energy in his sweeping change of the personnel of the top organs of the party apparatus. At the present time, only Gromyko and Shcherbitsky (besides Gorbachev himself) remain from the Brezhnev Politburo. He has obviously built a powerful support there, though he still faces criticism of his policies. Also, it is clear from the record of the Central Committee plenary sessions of January and June 1987 that he has some distance to go in building support in the Central Committee for his programs. He shows great skill in settling for a usable general formula rather than an explicit acceptance of his proposals, using the former as a springboard for the next attack.

13. See Elizabeth Teague, "Charges of Resistance to 'Restructuring' Intensify," *Radio Liberty Research*, January 26, 1987.

14. *Izvestiya*, December 4, 1986.

15. The complete text of the "Law of the Union of Soviet Socialist Republics on The State Enterprise" was published in *Pravda* and *Izvestiia* on July 1, 1987, pp. 1-4.

Senator **Proxmire** [presiding]. Thank you, Mr. Reddaway.

Mr. Colby, please proceed.

STATEMENT OF WILLIAM E. COLBY, FORMER DIRECTOR, CENTRAL INTELLIGENCE AGENCY

Mr. **Colby**. Thank you, Mr. Chairman. I will summarize my remarks. It won't take me long.

I think the basic problem is to avoid being either overly exaggerative of the Gorbachev reforms or, on the other hand, minimizing them as just more of the same. Either of those approaches can lead to very flawed policies.

LIMITS OF THE REFORMS

The first point I would make is that the reforms to date are certainly limited in scope. They are not an attempt to revolutionize the Soviet economy or the Soviet society. They are in reality a reaction—not an initiative—stemming from the stagnation and failure of the Soviet economy and society in recent years. Thus, the absolutism of the command economy is being gingerly released in a few areas, such as permitting an individual to drive a taxi, but forbidding him to rent it out to another to drive it outside his family.

The same can be said of giving factory managers some more authority, but in no way changing state ownership, and allowing the peasants to use their private plots and sell the product, but not to open up the collectives into any new approach toward agriculture.

OUTLOOK FOR REFORMS

Will these reforms, limited as they are, work to make the Soviet economy flourish? I think the answer is clearly not, precisely because of their limited scope.

They will also be limited by a much more important factor, the structure of middle level leadership which must be used to carry out these reforms. The apparatchiks of the Communist Party of the Soviet Union depend for their power and their perks on the authority that they have to manage the economy and direct the people. Every step of freeing the citizens from their heavy hand reduces their power.

Mr. Gorbachev is no Deng Xiaopeng who faced a party which was shattered in the aftermath of Mao's cultural revolution. Mr. Gorbachev has merely captured control of the top level of the machinery of his government and his directives must pass through the very people whose power will be reduced to the extent that they are implemented.

Thus, we don't see the kind of change which took place in China, the opening up of agricultural production which resulted in a doubling of grain production in 5 years, the stimulation of the Shanghai entrepreneurial spirit, and reducing the Chinese armed forces by 1 million of its 4 million men.

Mr. Gorbachev cannot think in those terms in any near term. He might hopefully get to that kind of prospect some day, but he certainly can't do it soon, and we must note that even Deng Xiaopeng had to backtrack from time to time when things seemed to be getting out of hand.

But if you ask the question whether the Soviet economy will improve rather than flourish, I think a more positive answer is possible. Mr. Gorbachev seems well aware of the importance of the art of the possible and deliberately is not overstating his hopes. He has moved effectively to replace leaders too rigidly adhering to the old school with ones who will try at least to bring about modest change.

You must always remember that the Soviet citizen does not judge his status in comparison with the American or even European situation. He compares his situation with his situation a few years ago or his parents' situation. If Mr. Gorbachev can meet this test by showing modest improvement, he should be able to continue his gradual process of perestroika and eventually make some real changes in the Soviet economy. But this cannot occur in the short term.

ARMS CONTROL

From the American point of view, it is my position that we should welcome Mr. Gorbachev's program for the simple reason that it can reduce the threat of nuclear war between the superpowers. Since he is limited in the degree to which he can restructure the Soviet economy in the short term and yet must show results, he is particularly interested in using resources to show some economic improvement rather than using them only to increase Soviet military power.

He cannot take on the Soviet military directly because of its power in the Soviet state, its support among the general population and its role in maintaining Soviet superpower status. But he can approach the subject indirectly by seeking arms agreements with the United States which can limit additional dimensions of spending in a high technology arms race such as the SDI would produce.

He can even begin to reduce the current requirements to maintain Soviet forces at their present level through substantial arms reductions. And he has even broached the idea of establishing on both sides of the Warsaw Pact-NATO relationship a basic concept of having conventional forces only for defensive purposes and not strong enough to conduct offensive.

Now, that is a general idea. It is in its infancy. But it shows the direction that we could be moving. This is not a sudden rash of altruism in Gorbachev's mind. It is, rather, a cool analysis that the Soviet Union cannot maintain world superpower status unless it can become an economic superpower, which it has increasingly failed to do in recent years.

It has maintained its status by devoting an inordinate amount of its talents, budget and resources to the military which resulted in a stagnant economy, and a dispirited—or perhaps overly spirited—work force. President Reagan's announcement of the SDI program means in Mr. Gorbachev's eyes even more resources for the military to prevent the Soviet Union from being vested in this new arms race in space and a corresponding inability to improve its economy.

IMPLICATIONS OF CONTINUED ARMS RACE

Some Americans believe this is all of little moment for the United States; that indeed it is in the American interest that the Soviet economy remain a failure until the Soviet political and economic system changes entirely. I believe this idea ignores the devastating possibility of nuclear war as long as the huge superpower arsenals remain pointed at each other. It is only through negotiation between them that this danger can be first reduced and possibly eventually eliminated.

It also ignores the huge expenditures required of the United States to maintain current forces and to increase them by the addition of an SDI. And certainly a change of our superpower competition from the military to the political and economic field would leave the United States well ahead and guarantee that it will remain there.

U.S. POLICY

So with Mr. Gorbachev we now face a window of opportunity to negotiate sweeping reductions in nuclear arms. The Reagan administration is to be commended for moving ahead on the prospect for an agreement on intermediate nuclear forces, and I hope the Senate will speedily ratify the resulting treaty.

We should also lay the groundwork for similar agreements on strategic forces and for a clear understanding that the ABM Treaty of 1972 bars an arms race in space. Aside from the credit this would give our President, it would be an important achievement for Mr. Gorbachev, demonstrating that he can produce results in his negotiations with the Americans which can reduce the need for further Soviet military expenditures and free resources for use in the Soviet economy.

In fact, this is almost the only field in which Mr. Gorbachev can show results from his leadership and new thinking in the short term to help him maintain his position and the direction he has set for Soviet policy.

The alternative is dismal. If his initiative to open Soviet society even so slightly and negotiate with rather than threaten the Americans fails to produce results, the most likely result is a reversion to the hard Stalin-like line which is always close to the surface of Russian political life. The implications of such a turn to the international community and to the United States as the leader of the free world do not suggest that we yield to every demand of Mr. Gorbachev, but that we negotiate forcefully to achieve the arms control agreements he says he is prepared to sign.

Even if he were later replaced, a bedrock of firm treaties could limit the further growth of these weapons pointed at us or call us to arms in the event of repeated and flagrant violation.

In short, Mr. Chairman, Peter the Great was a more desirable international companion than Joseph Stalin, and we should take advantage of the promise presented by Mr. Gorbachev.

Thank you.

[The prepared statement of Mr. Colby follows:]

PREPARED STATEMENT OF WILLIAM E. COLBY

Thank you, Mr. Chairman, for this invitation to testify on the important subject of the economic reforms General Secretary Gorbachev is trying to make in the Soviet Union, and their strategic significance to our nation and the world. It is all too easy to exaggerate or to minimize his program from an excess of enthusiasm or suspicion, and to jump from such error into flawed policies.

In this hearing you have wisely sought expert analysis of exactly what these reforms entail, and I do not presume to match the scholarship and wisdom of your other witnesses. I merely note that the reforms are limited in scope, and certainly in the near term will not revolutionize the Soviet economy or society. They are in reality a reaction as much as an initiative, stemming from the stagnation and failure which the Soviet economy and society have suffered in recent years. Thus the absolutism of the command economy is being gingerly released in limited areas, not overturned entirely, such as allowing workers to moonlight by running their own taxis, but not permitting them to rent them to other drivers outside their own family. The same can be said of giving factory managers some greater discretion than the comprehensive master plans previously allowed but not changing the fact of state ownership, and allowing peasants to sell the produce of the private plots they formerly could use only for themselves but not dissolving the great collectives.

Will the reforms work to make the Soviet economy flourish? A short answer is that they will not, precisely because of their limited scope. More importantly, they will be limited in their effect by the structure of middle level leadership which must be used to carry them out. The apparatchiks of the Communist Party of the Soviet Union depend for their powers and perquisites on their function as the directors of the economy and the society of the nation, and each step toward freeing the citizens from their heavy hands adversely affects them. Mr. Gorbachev is no Deng Hsiao Ping facing a Party shattered in the aftermath of Mao's Cultural Revolution; he has merely captured control of the top level of the machinery of government and his directives must pass through the very people whose power would be reduced to the extent they are implemented. Thus we do not see the kind of initiatives which took place in China, opening the markets to peasant production which doubled grain production in five years, stimulating the Shanghai entrepreneurial spirit and reducing the armed forces by one million of its four million men. Mr.

Gorbachev may look forward to such initiatives, but the way to get to them must be cautiously and gradually built (even Deng has had to backtrack when enthusiasm appeared to be getting out of control).

But if the question is whether the Soviet economy will improve rather than flourish, a more positive answer may be possible. Mr. Gorbachev seems well aware of the importance of the "art of the possible" and deliberately is not overstating his hopes. He also has moved effectively to replace leaders too rigidly adhering to the old school with ones who will try to bring about at least modest change. It must always be remembered that the Soviet citizen does not judge his status against an American or even European standard, but against his or his parents' situation a few years back. If Gorbachev can meet this test by improving that comparison, and he may, he should be able to continue a gradual process of perestroika, and eventually make some real changes in the Soviet economy.

From an American point of view, we should welcome Mr. Gorbachev's program for the simple reason that it can reduce the threat of nuclear war between the two superpowers. Since Mr. Gorbachev is limited in the degree to which he can restructure the Soviet economy in the short term, and yet needs to show results, he is particularly interested in using resources to show such economic improvement rather than using them to increase Soviet military power. He cannot take on the Soviet military directly, because of its power in the Soviet state, its support among the general population and its role in maintaining Soviet superpower status. But he can approach the subject indirectly, first by seeking arms agreements with the United States which can limit additional dimensions of spending in a high technology arms race (read the SDI) and even begin to reduce the current requirements to maintain the Soviet forces at their high present levels. He has even broached the idea of establishing on both sides of the Warsaw Pact - NATO relationship the concept of forces adequate only for defense, not offense, which could reduce current conventional force levels.

This is not a sudden rash of altruism in Mr. Gorbachev's mind. It is rather a cool analysis that the Soviet Union cannot maintain world superpower status unless it can become an economic superpower, which goal it has increasingly missed in recent years. It has maintained its status by devoting an inordinate portion of its talents, budget and resources to the military, which resulted in a stagnant economy and a dispirited (or perhaps overly spirited) work force. President Reagan's announcement of the SDI program means in Mr. Gorbachev's eyes even more resources for the military to prevent the Soviet Union from being bested in this new arms race in space, and a corresponding inability to improve its economy.

Some Americans believe that this is all of little moment to the United States, that indeed it would be in the American interest that the Soviet economy remain a failure until the Soviet political and economic system changes entirely. I believe this ignores the devastating possiblity of nuclear war as long as the huge superpower arsenals remain pointed at each other. It is only through negotiation between them that this danger can be first reduced and possibly eventually eliminated. It also ignores the huge expenditures required of the United States to maintain current forces and to increase them by the addition of an SDI. And certainly a change of our superpower competition from the military to the political and economic field would leave the United States well ahead.

With Mr. Gorbachev, we face a window of opportunity to negotiate sweeping reductions in nuclear arms. The Reagan Administration is to be commended for moving ahead on the prospect for an agreement on intermediate nuclear forces and I hope the Senate will speedily ratify the resulting treaty. We also should lay the groundwork for similar agreements on strategic forces and for a clear understanding that the ABM Treaty of 1972 bars an arms race in space. Aside from the credit this would give our President, it would be an important achievement for Mr. Gorbachev, demonstrating that he can produce results in his negotiations with the Americans which can reduce the need for further Soviet military expenditures and free resources for use for the Soviet economy. In fact, this is almost the only field in which Mr. Gorbachev can show results from his leadership and "new thinking" in the short term to help him maintain the direction he has set for Soviet policy.

And the alternative is a dismal one. If Mr. Gorbachev's initiative to open Soviet society even so slightly and negotiate with rather than threaten the Americans fails to produce results, the most likely result is a reversion to the hard Stalin-like line which is always close to the surface of Russian political life. The implications of such a turn to the international community, and to the United States as the leader of the free world, do not suggest that we yield to every demand of Mr. Gorbachev, but that we negotiate forcefully to achieve the arms control agreements he says he is prepared to sign. Even if he were later replaced, a bedrock of firm treaties could limit the further growth of these weapons pointed at us or call us to arms in the event of repudiation or flagrant violation.

In short, Mr. Chairman, Peter the Great was a more desirable international companion than Joseph Stalin, and we should take advantage of the promise presented by Mr. Gorbachev.

Senator **Proxmire**. Thank you very much, Mr. Colby, Mr. Reddaway, and Ms. Rice. I am sorry I wasn't here for your statement, Ms. Rice, and for much of your statement, Mr. Reddaway. I have had a chance to read them and they are excellent.

THREAT OF NUCLEAR WAR

We will each take 5 minutes on the first round in questioning.

Mr. Colby, you seem to have quite an optimistic view of our opportunities now, not so much in any trust of Gorbachev or distrust of Gorbachev, but because you think that the economic situation would compel the Soviet Union to recognize the importance to them, their economic progress in the long run for holding down their military spending.

You said that you felt that Gorbachev and his policies reduced the threat of nuclear war. In what way?

Mr. **Colby**. If we go ahead with these negotiations and reduce the numbers of these weapons pointed at us and the degree of hostility that they represent, then I think we do reduce the threat of nuclear war; that indeed these treaties can be added with many elements, such as the crisis center management that we are discussing, such as the various kinds of verification arrangements, cooperative arrangements for verification which reduce the hostility as well as the physical nature——

REDUCING DEFENSE SPENDING

Senator **Proxmire**. But you also say that what the Russians are interested in, what Gorbachev is interested in, is easing the economic cost. And the economic cost is largely a conventional weapons cost, is it not?

He has discussed negotiating reduction of conventional weapons on both sides. Is that a real, practical possibility in your view, the verification and so forth?

Mr. **Colby**. I think it is. I think that it is possible to work toward a reduction of the two forces facing each other in Europe.

SDI

I think Mr. Gorbachev's main problem is the danger of a technological arms race stemming from the SDI. Not that that means that he is afraid of being bested, but that he realizes that he must take steps to meet and overcome what would be a threat to him. And that would require an especially new effort in talent, resources, and military force.

MARKET SOCIALISM

Senator **Proxmire**. Mr. Reddaway's prepared statement makes a distinction between in-system reform and fundamental reform. Is the Stalinist economic system undergoing fundamental reform or is something less than that taking place? Is Moscow moving toward market Socialism? And what policies or institutions would have to be changed for there to be fundamental reform, and what should we look for to know that it is or is not happening?

Mr. **Reddaway**. Professor Ellison argues, and I would agree with him, that today there is a very little evidence of the Soviet Union moving toward a market-type Socialism. If he were to start moving in that direction, the signs we would have to look for in my opinion, some of them would be as follows:

BLACK MARKET

First of all, you would need a very broad-scale legalization of the current black economy, black or second economy, which at the moment exists in a state of illegality or semi-illegality. That involves various services and a whole range of activities on which in fact the state economy does rely to a considerable extent, but it is illegal in pursuing those particular contacts.

PRICE REFORM

A second very significant area of reform which has been discussed in a tentative way already, but nothing has yet been done to introduce such reforms, is a radical reform of the pricing system. What would be needed here would be making the prices of particularly basic foodstuffs such as bread and meat and also of rents represent a reasonable market value. And at the moment, they are wildly out of line with the real market value.

There has been talk of introducing such reforms of the pricing system very gradually by stages over perhaps a 2- or 3-year period, starting perhaps in 1990 or something like that. So the political sensitivity and delicacy of this very fundamental issue is obvious and it is to my mind very uncertain indeed how resolute they will be on that point. But if they do start going about that seriously, that will be a sign of moving toward creating a market for the obvious reasons.

Another sign would be a real assault on the ministerial structure. Mr. Khrushchev carried out such an assault in 1957 when he dismantled the greater part of that structure and set up a network of regional economic councils. That, however, led to increased confusion in the planning and administration of the Soviet economy and those regional economic councils were dismantled very rapidly after Mr. Khrushchev's removal in a palace coup in 1964.

MANPOWER REDUCTION

There has been a lot of talk and even a little bit more of talk—plans—for doing something similar to the present Soviet ministerial structure, although not in terms of creating regional economic councils. There are other alternatives being discussed.

If we see the total manpower of the ministries being reduced by 50 percent, which is the figure that is being tossed around in Moscow, and if we see a sensible redeployment of that enormous manpower from the ministerial structure into more local situations, then that would be another sign that things were moving toward a market economy.

BANKING AND JOINT VENTURES

A fourth sign that I might mention would be a reform of the banking system to make it much more flexible and much more responsive to market needs. There is very little sign of much serious thought being given to that, although there are some indications.

Finally, I could mention a much more radical law on joint ventures with foreign firms. Those would be some of the signs.

Senator **Proxmire**. Thank you very much, Mr. Reddaway.

Congressman Fish.

Representative **Fish**. Thank you, Mr. Chairman.

I certainly welcome this panel for such interesting insights.

THREAT OF NUCLEAR WAR

Mr. Colby, I would like to address your statement that the United States should welcome Mr. Gorbachev's program because it can reduce the threat of nuclear war, and ask you three questions related to that.

What do you think of the proposition that the presence of enormous nuclear power on both sides and the threat of its use has in fact prevented war between the United States and the Soviet Union for several decades?

Second, that if we proceed with the series over the years, a series of arms control agreements, and at the same time the Soviet Union's influence, its prestige is not recovering, its economic power remains stagnant, does that increase as the number of nuclear weapons on either side gets smaller and smaller, does that not increase the danger of nuclear war?

Third, what about the fact that as we have reduced reliance on strategic forces, won't we really be magnifying the Soviet superiority in conventional forces?

Mr. **Colby**. Thank you, Congressman Fish.

AVOIDANCE OF WAR

On the first one, I think certainly the evidence is that the existence of the superpower arsenals has been accompanied by an absence of war between them. I don't know whether it is a cause or just a fact.

I think that it is quite clear that both of the superpowers are deterred from the use of their nuclear forces. My position is very clear that nuclear weapons are just unusable by any rational test these days because of the dangers of absolute retaliation. And I think we have seen that factor at work in various of the crises between us, in Berlin and the eastern Mediterranean in 1973 and in other kinds of major crises.

So the fact is that yes, you can say we have avoided a war because we would have to have an ultimate war. We have even tried to avoid even small incidents between Soviet and American forces. We have a treaty that stops this game of playing chicken on the sea between our destroyers out of fear of escalation if any sort of local fight starts.

That is a thesis, but I think it is vulnerable to the danger that these weapons pose. They are so enormous in their impact that I think a small risk is an enormous risk for our country and for mankind. A small risk of its use, but still the results are so horrendous that I think it is a major threat to safety on both sides. The danger of accidental war, the danger of demonstration shots, things of this nature, all of the kinds of thinking that people can go through becomes more and more the basis for it.

We are changing some of the systems for these weapons so that the flight times are very substantially reduced and the low trajectory submarine-launched missile off our coast would be in Washington within 7 minutes. An intercontinental weapon takes a half hour to get here, which gives us time to go through the scrubbings of the false alarms that we have had over the years. We have had a lot of false alarms and some of them have actually gotten to a fairly serious state where we have had to really take a look to see whether this is a threat coming at us or not.

Luckily, we have scrubbed through those false alarms. I wish I were as confident of the Soviet system of scrubbing through its false alarms, because the danger could come just as much from there as from here.

DETERRENCE WITH FEWER WEAPONS

On the second question, whether fewer weapons become more likely to be used. I think the effect of these weapons is such that they are not likely to be used in any rational sense. I believe President Carter once asked the question—and I think it is really a surprisingly good question—of the Pentagon, why do we need more than 200 strategic nuclear weapons?

If your purpose is deterrence, you are going to be deterred by 200 nuclear weapons. If your purpose is something else, then yes, more.

So I am not sure that we are ever going to get down to zero. I am not sure that we are ever going to get down to 10, which then becomes a potential along the line you say. But if we could get these massive arsenals under control, I think we would be in very much better shape in terms of our safety and security, and we incidentally would be in very much better shape in dealing with the proliferation problem into Third World countries.

PATH TO NUCLEAR WAR

Representative FISH. If I could interrupt at that point just to refine that question, because I appreciate your answer, and I certainly agree with you that nuclear war is simply not an option, as you said, used in the rational sense.

I wasn't really thinking of the rational sense. I was thinking of a time when Soviet pride and influence is severely damaged, that perhaps a decade from now the SDI is near a successful deployment, and that with a few arms left the Soviet Union might be tempted to sort of lash out.

Mr. COLBY. I agree with your point, Congressman Fish, that the fear is not a World War II mad dictator launching an attack on the world. The fear is much more a World War I syndrome of tensions rising, actions taken, reactions made, and the great powers in that incident got into a 4-year war which killed 20 million people and the historians can't tell you what the war was all about.

That is the danger that the nuclear arsenals pointed at each other present to us, and in that sense a few of them I think would still be deterred by the existence of a few on the other side; in other words, the 200 limit.

Below that, if we ever got to that, that would be practically heaven. We could then figure out whether we could go any further.

That would be a vast difference from the 25,000 that each side possesses at this point.

Representative **Fish**. Thank you very much. My time is up. I know I asked you three parts, but you have been extremely helpful.

Senator **Proxmire**. Senator Sarbanes.

COMPARISON WITH CHINA'S REFORM

Senator **Sarbanes**. I am interested in the question of why the Chinese seem to be going so much further than anything Gorbachev contemplates.

Mr. Colby, you touched on it only briefly and suggested that the destruction wrought in the party in China enabled Deng Xiaopeng to make much sweeping changes. But I wonder whether you would want to add anything in response to that question; and I'd be interested to know what the other two panelists may have to say on it.

Mr. **Colby**. No. I think that is the main point. The Chinese party apparatus really did not have the ability to resist to the degree that the existing Soviet apparatus does.

I think there is also something to be said for the general Chinese entrepreneurial spirit which is still alive there, despite Mao's period. It revived very quickly, particularly in the peasant world. Remember, China is still heavily rural and heavily peasant in nature. So I think that had something to do with the success on the agricultural side.

Mr. **Reddaway**. If I could add to that, I think that the Chinese entrepreneurial spirit is alive partly because communism has been operating in China for only 38 years as compared to 70 years in the Soviet Union.

A further point is that the party and state apparatuses in China were very, very severely weakened by the so-called cultural revolution in the years between 1966 and 1976 and therefore were not able to resist the recent reforms anything like to the extent that the Soviet party and state apparatuses are able to resist successive reform efforts by Mr. Khrushchev and now by Mr. Gorbachev.

Ms. **Rice**. I would agree generally with the thrust of those comments and add that the Stalinist bureaucratization of the 1930's was, of course, hardened by World War II and one must add an international dimension to this. China is really a regional power at best. The Soviet Union is a superpower with an enormous military. It was mentioned that the Chinese demobilized by 1 million men. It is difficult to imagine that in the Soviet Union. I think the ministry structure in the Soviet Union is much harder and faster than on the Chinese side, and many of those have come from the demands of maintaining large military forces and a heavy industrial base.

IMPLICATIONS FOR THE UNITED STATES OF A STRENGTHENED SOVIET ECONOMY

Senator **Sarbanes**. I am not quite clear that I follow the line of reasoning concerning the national security implications for the United States of improvements in the Soviet economy.

The view seems to be that if their economy improves, that will have positive implications for our national security posture. That is contrary to the way you generally look at things, isn't it? You seem to be saying, well, if they strengthen their economy and their economic base, that will constitute a greater threat rather than a lesser threat.

I wondered if the panelists would address that point.

Ms. **Rice**. Senator Sarbanes, I think it depends in great part on what the Soviets would do with that greatly rejuvenated economy. The hardest thing to judge is the intentions of one's adversaries. I think I suggested that I don't think Soviet Union objectives in being an active competitor of the United States in the international system have changed.

If the Soviets turn their economic power to trying to broaden the base of Soviet foreign policy, Soviet influence, through economic and political instruments instead of through military instruments, then while the Soviets would be a very, very tough adversary, I think the United States would fare very well in that environment and we would be somewhat safer. It is always good not to have the Soviet Union attempting to throw its military weight around.

If, on the other hand, that economy really comes back to support a more sophisticated, stronger, technologically and in terms of efficiency, military which becomes again the center of Soviet foreign policy, then I think we really do have the worst of both worlds. We have strengthened the technological base of the Soviet Union and they have applied it to their military strength.

I think that some of the differences that you may be picking up, or the reason that it seems a bit like a contradictory answer is that we simply do not know what they intend to do with that power. Some of us would like to hope that an improved Soviet economy would give them instruments other than their military power to use in the world.

Mr. **Reddaway**. I think, Senator Sarbanes, you have raised a very fascinating question. I personally think that your perspective could turn out to be correct; that it might not necessarily be in the interests of the United States for the Soviet economy to do very well.

I would also endorse what Ms. Rice has said; that long-term Soviet aims are not terribly clear. They say very little indeed about them.

If I could, however, put in one view which portrays my own overall view about the perspective for the next few years, it is a perhaps somewhat more optimistic line and supports Mr. Colby's view, though perhaps for slightly different reasons.

I myself am rather skeptical about the possible success of Mr. Gorbachev's reform program. I personally think it is, on balance, likely ultimately to fail—not in the immediate future, but it will be messy. I personally think it will be a question of—as with the previous reforms throughout Russian and Soviet history, most of them—it has been a question of three steps forward, two steps back. And I rather suspect that is what will happen with Mr. Gorbachev.

But the reason why this may nonetheless be useful for the United States and our security is as follows. I think the logic of Mr.

Gorbachev's present position is that he does sincerely want to make various deals, both in the arms control field and in other fields, with the United States and other major foreign powers.

I think if we take that window of opportunity, if we take advantage of it, we can obtain various deals which are of mutual advantage, advantage to both sides.

OUTLOOK FOR REFORM

The ultimate threat that you posit as a possibility—of the Soviets becoming very much stronger and therefore ultimately a greater threat to the United States—I do not think that is going to come to pass, because I think ultimately—and not just ultimately—I think in the medium term within the next decade, these reforms are likely to run into the sands as previous reform programs have. Therefore, we will not ultimately be faced by the prospect you outlined.

Mr. **Colby.** My feeling on this, sir, is that these changes are going to be limited. They are not going to be that great. They are not going to reform the whole society. But to the extent that they happen at all, they are going to require a saving of huge investment in the military and particularly a huge new arms race.

VALUE OF ARMS CONTROL

Since that is the fact, the Soviets will be willing during this window of opportunity to make some very far-reaching agreements to limit the future growth of these weapons.

Now, once they are made, they are very hard to break. Of course, you could get a whole revolutionary crew there that just repudiates them all, an Ayatollah Khomeni or something like that. But I think that the prospect of that kind of a total change in the Soviet system is not high. You are more inclined to get more of a more bureaucratic approach and less of a glasnost' approach, and therefore they would be inclined to stick to whatever treaties they made because it would be in their interest as well, not just ours, and it would establish a benchmark which you don't go beyond in these weapons.

Senator **Proxmire.** Congressman Scheuer.

TWO SIDES OF SOVIET POLICY

Representative **Scheuer.** Thank you, Mr. Chairman. It has been a marvelous hearing. One becomes a schizophrenic trying to analyze the Soviet Union. I was part of the group that went to Moscow last April, and you meet Mr. Gorbachev and you are certainly impressed with his sharp brilliance, his apparent sincerity. You get the feeling he really wants to deflect resources away from the military, into improving the quality of life and to spreading glasnost' and a sort of more relaxed Soviet life.

OFFENSIVE POLICIES

Then you observe some of the continuing policies of the Soviet Union that are in stark contrast with that: their policy on human rights, where they are continuing systematic flagrant disregard of international obligations which they freely assumed.

Now we are reading a lot of headlines. They are letting go a few of the more well-known and internationally known refuseniks, a half dozen or so. This process is going on right now as we read our morning papers. But there is apparently nothing that is being seriously considered about the 400,000 Jews that want to get out, Germans that want to get out, and any of the other ethnic groups that want to get out.

There has been nothing about institutionalizing the glasnost' that Mr. Gorbachev and other leaders talk about. I read an article in the New York Times just yesterday or the day before, where our State Department is trying to push them to the point of institutionalizing some kind of respect for their international obligations and not just engaging in a little public relations glitz from time to time.

We see the Toshiba incident, which indicates they are spending millions of dollars a year to try and steal foreign technology wherever they can, especially from us. We look at their horrifying attacks on us that absolutely boggle the mind on any number of issues. The latest is their effort to convince the world that AIDS is a product of American conspiracy to thrust this on an unsuspecting globe.

ARMS CONTROL INITIATIVES

How do we factor this face of Russia in with the face of Russia that Mr. Gorbachev has presented to congressional groups, one after the other, to the French, to the British, all over the world, to these remarkable offers that he is making on arms control and reduction of nuclear forces where he does seem to be winning the propaganda war, even in the West, even among sophisticated Western cultures and nations?

You see, this is the charming Gorbachev, but then you look at these other aspects of Soviet society, their absolutely unyielding intransigence and recognizing their international obligations, disinformatia programs, systematic billion dollar efforts to steal and connive, to corrupt our allies and get products of our technology. How do you factor these two totally conflicting elements of Soviet society, and how do I work my way out of my absolute schizophrenia as I look at it?

GLASNOST'

Mr. Colby. I think one way is to consider what the meaning of the word "glasnost'" is, because a Westerner says it means openness, it means letting you look into me. You have the initiative to do what you will. I think the Soviet meaning of the word "glasnost'" is quite a different meaning. It means essentially to spotlight, putting the spotlight on things, using publicity to achieve a result.

That means that that publicity is being controlled for a particular purpose, and I think in that sense Mr. Gorbachev's glasnost' is a follow-on of the concept that authority comes from the politboro and it comes down. They don't have the concept that power comes up.

You are not going to change that in Soviet life. The Communist system is there and it is going to be there. Even if you got a Czar, I suspect you would have the same thing. There is a lot of Russian in it.

FUTURE SOVIET BEHAVIOR

Representative **Scheuer**. Ms. Rice, you said we don't know what the Soviets want to do with that. Some of these other things that I have mentioned, the absolutely ignoring of their human rights, the Toshiba incident, this AIDS disinformatia, does that give any clue? Is it legitimate to look at those things for a clue as to how they intend to use that power and their perception of what their relationship is with the entire Western world?

Ms. **Rice**. I think that it is clear and it has been clear for 70 years and I don't expect them to change, Congressman Scheuer, that the Soviet Union sees this as an adversarial relationship, and in an adversarial relationship things like Toshiba are completely legitimate from their point of view.

I guess my short answer would be I would tend to look at Soviet actions rather than Soviet words in this period of time. We cannot behave as if the Gorbachev reforms and the new foreign policy are accomplished facts. We have to look at what the Soviets are doing.

I would agree with Mr. Colby and I think Mr. Reddaway, that in the arms control field, we are getting Soviet proposals that we can act on. We can judge the adequacy of those proposals. We can judge their impact on our own military power, and I think that is the process that we have to go through.

We have tried, I think, to open up the prospects for the future here, but we can really only proceed 1 day or 1 year at a time with this Soviet Union which is in a great state of flux but whose objectives have not changed toward us. And that is we are their great adversary; they wish to extend Soviet influence, institutions, and political values in the world, and I think we have to take each Soviet move on its merits.

POLITICAL CONSTRAINTS ON GORBACHEV

Mr. **Reddaway**. I sympathize with your feeling of schizophrenia, Congressman Scheuer. I think I do have a partial answer for you.

I don't think it is understood very much in the West how deeply divided the Soviet political elite is, what the Soviets call the nomenklatura, the nomenclature. This is a large group of people who occupy all of the politically sensitive positions in party, state, military KGB, at the center, at the Republics, at the regional and even at the district levels.

We tend to think that when Mr. Gorbachev took power 2½ years ago, he somehow brought in a new administration in the same way that a new President brings in a new administration here or a new prime minister in parliamentary systems.

The answer is that he did not. He did not bring in a new administration. As we know, that means making several hundred appointments, political appointees to key positions in the bureaucracy who will be united, and will carry out the president's or the prime minister's wishes.

He did not have that opportunity. That is not how the Soviet system works. He has to fight for every single personnel change that he wants to make. He has to make an enormous number of compromises with his colleagues.

If you take just one category, a particularly important category, the regional barons who are traditionally extremely important and powerful in the Soviet Union, the first party secretaries of the regional party committees, a very small percentage of those have been appointed in any sense by Mr. Gorbachev personally. So Moscow can decide what it wants, but if you have the first regional party secretaries not in accord with his thinking, not behind the particular reforms he is trying to implement, you are not going to get very far in the Soviet Union, and Mr. Gorbachev sometimes makes his frustration on precisely this sort of issue explicit. We can actually read it in some of his speeches.

LIMITS OF GORBACHEV'S POWER

One of the points I mentioned where I diverge somewhat from Professor Ellison's prepared statement—I think he exaggerates the extent of Mr. Gorbachev's political power and I think a lot of Western observers do that because, like you, they meet Mr. Gorbachev and they are struck by his remarkable dynamism, by his flexibility, and they think this guy is in charge, this guy is doing what he wants in this country. That is far from the truth, and if you read his speeches you can see it.

If I could elaborate a little bit, he has made a number of gains within the political elite. He managed to make appointments of his supporters to a number of positions, especially in the secretariat of the central committee, to some extent in the politboro, but he has met a lot of rebuffs. He has a lot of opposition to him in the central committee, and this is one of the reasons that he wants to have a special party conference next year, because he hopes he will be able to get rid of a further number of his opponents from that central committee. We will have to see whether he succeeds.

But he has been rebuffed repeatedly by the political elite, the nomenklatura, on a whole range of issues. Just to give you some examples, he has pushed very hard to have a much freer system of elections within the party. The central committee has rebuffed him on that. He wants a much freer system of elections within the Soviets—the local councils and the central councils of the supreme Soviet. He has so far been rebuffed on that, except for experiments. Experiments have been carried out, but on the basic principle he has not yet got his way.

On election of managers in factories, he wants those managers to be elected by workers. He wants even the foremen in charge of workshops to be elected by workers. He has so far again not got his way on that.

His latest idea is a Khrushchevite idea, to have compulsory turnover of party officials at all levels so that they would have fixed terms.

Representative **Scheuer**. We would all agree that that is a terrible idea. [Laughter.]

Mr. **Reddaway**. Well, you have fixed terms and you have to live with it. He doesn't like the situation where Mr. Brezhnev could be number one for 18 years and a whole lot of Brezhnev appointees around the country would be in position for 18 or 20 or even more years. He wants to get away from that.

The fact that Khrushchev introduced compulsory turnover was precisely one of the reasons Mr. Khrushchev was overthrown. So if Mr. Gorbachev does it, it will be a very risky move.

So that is my general line of argument.

Representative **Scheuer**. I must say that was extremely interesting. I appreciate all your answers.

Thank you, Mr. Chairman.

Senator **Proxmire**. Thank you, Congressman Scheuer.

UNITED STATES-SOVIET CONFLICTS

Ms. Rice, you show that the Soviet approach of a powerful military and a weak economy has led to many failures in foreign policy that will take years, maybe decades, for the Soviet economy to be transformed into a real instrument in international politics, if it is at all.

Meanwhile, the Soviets can only use skillful diplomacy and create an image of a revitalized society.

I have two questions in this respect. First, are we properly exercising our advantages as a military and economic power in the Persian Gulf and in Nicaragua?

Ms. **Rice**. I think that the United States in general does not take advantage of the full range of instruments before it. The Soviet Union is confined largely to its military power and in our competition with the Soviet Union I think we have been too quick to rely also on the military instrument and to, in effect, play this game on a playing field that is more advantageous to our enemy than to us.

NICARAGUA

That governs primarily comments about Nicaragua, where I think that the clear message to the Soviet Union should be made that there are military moves that we will not tolerate in Nicaragua. We will not tolerate offensive bases in Nicaragua. And I think that the Soviets would respect that because they are not going to challenge American military power in this hemisphere.

I would rather see us concentrate on a broader range of instruments, including economic power and perhaps even guaranteeing Nicaragua which I think is an economy that might fall of its own weight. I think the Soviets are somewhat less sanguine about their relationship with Nicaragua, as evidenced by their recent cut in imports of cheap oil to Nicaragua. So I think, sir, that there we could make better use of our own instruments and less of the military instrument which plays to the Soviet hands. It is all they have got.

PERSIAN GULF

Senator **Proxmire**. How about the Persian Gulf?

Ms. **Rice**. In the Persian Gulf, it is a very difficult situation. I understand the frustration of the administration in the Persian Gulf, particularly with Iran. I think that what may have been a bad policy or policy for a bad reason, which was to go flying in after the Soviets who had decided to lease tankers to the Kuwaitis, our feeling that if the Soviets were there we had to be there. I think that reflexive response was a mistake.

However, I do think the policy has been managed fairly well, and now we are beginning to see the Europeans come on board. The Iranians are being isolated. The peace initiative that is going to take place under the Secretary General of the U.N. may be backed up with a little bit of Western muscle, and I don't think that is necessarily a bad thing.

U.S. DEBTOR STATUS

Senator PROXMIRE. The second question is, does the fact that we are the world's largest foreign debtor harm or have the potential for harming our image as an economic power?

Ms. RICE. I think that it is a second-order problem for us, the debt, and that is its effect on the American economy as a whole. We forget that the real source of strength for American foreign policy, post-World War II, was American economic power and our ability to rebuild Europe and Japan because of our great economic strength.

It is really on that basis that the United States was a hegemonic power until the rise of the Soviet Union in the late 1960's.

So the state of the U.S. economy domestically and the impact that has on our ability in the international economic system I think is at the very core of whether or not we can exercise our foreign policy options fully. To the degree that the debt is representative of a decline in American economic power abroad, I think that it is a problem for us.

OUTLOOK FOR GORBACHEV

Senator PROXMIRE. Mr. Colby, as Director of Central Intelligence, you must have read reports about the Soviet Union, assessing the Soviet leadership, the various political factions and interest groups, prospects for challenges to the leadership, sources of unrest and so forth.

Possibly since leaving government you have been involved in private political risk assessments. Without giving away any state or trade secrets, can you give us your sense of whether Gorbachev is likely to keep up the momentum of change—I noticed Mr. Reddaway indicated he thought that Gorbachev probably would fail in his objective of resuscitating the Soviet economy—whether Gorbachev will be able to maintain his power base, or whether he risks being removed in the next few years?

Yesterday we had testimony by outstanding experts, at least one who thought that he wouldn't last much longer than President Reagan would.

Mr. COLBY. I think he will last longer than that. I think it depends very much on whether he brings home the bacon. In other words, he is on a leash right now. The management of the Soviet Union I think in my mind can always be compared a little bit with the management of a mafia, with a group of dons around the table, and they say, okay, you be the leader for a while and if it works, fine; and if it doesn't work, out you go.

Mr. Gorbachev has loaded up the table with a few of his people but he is not there alone, and he is on a leash right at the moment. He can run to a certain degree. He can't go beyond certain limits because of the resistance that the other interest powers in the Soviet society will have.

So the question is, can he produce results? I think he will have a hard time producing major economic results, but I think what he could produce is a result with the United States; in other words, a major arms agreement with the United States. And that would give him some bacon to put on the table, saying look what I have produced.

SDI

Senator **Proxmire**. Is the current agreement what you would consider a major agreement?

Mr. **Colby**. No, that is not enough. It is a beginning. It is a step in the right direction.

I think it is very clear that the thing is hung up on the SDI, and partly he is hung up on it, but partly the Soviets are fearful of the continued arms race in that area.

Senator **Proxmire**. How can they possibly agree to what the President proposed, a 50-percent cut in strategic arms, when the SDI might not work, probably won't, but can only succeed if the Soviet Union sharply reduces their offensive nuclear arsenal? How could he, under those circumstances, agree to make a cut from 10,000 to 5,000 nuclear warheads?

Mr. **Colby**. I think from a strategic point of view, the difference is marginal. I mean if you have 5,000 you would have more than enough to have an effect.

Senator **Proxmire**. Even facing an SDI coming on like gangbusters?

Mr. **Colby**. Remember, his reduction in that area is contingent on the stopping of the SDI. And you can understand why, because that is the problem—and it is not just the business of whether he becomes vulnerable to our 5,000—it is the arms race that he envisages as a result, because if we produce that SDI he is going to have to respond to it by producing enough weapons to penetrate, by producing some system to frustrate, whatever. That is going to mean a major investment of Soviet effort in that area.

I think he really does not look forward to seeing that kind of money used in that area because he can use it better to bring home the bacon in terms of the Soviet economy. And I don't think that is going to work all that well until it does have to loosen. But if he can take the steps to produce some improvement in the ordinary Soviet citizen's diet and living circumstances and reduce the lines a bit, why he will have gotten enough momentum to go for another little while.

It is a gradual thing. I don't think he is a sure thing, and on the other hand I do not think he is doomed. I think it depends on how well he produces in the two areas of foreign policy and in the economy.

Senator **Proxmire**. Congressman Fish.

Representative **Fish**. Thank you, Mr. Chairman.

GORBACHEV AND THE MILITARY

Ms. Rice, in your prepared statement, with reference to the defense budget in the Soviet Union you say, "Any thinking Soviet military man knows that the weakness of the Soviet economy and its technological base is ultimately a threat to Soviet military power in the 21st century." And you are referring to the fact that the battlefield will be dominated by high technology weaponry.

I would like to use that and ask you to elaborate on the relationship between the military and Gorbachev, in three areas. One, is the military a chief proponent of restructuring and hence an ally of Gorbachev?

Second, how does the military regard arms control?

Third, if you would comment on the significance of the replacement by Gorbachev of Soviet Defense Minister Sokolov with Yazov shortly after the young German pilot flew to the Kremlin landing strip.

SOVIET MILITARY

Ms. RICE. Congressman Fish, I think the most important thing is that there doesn't seem to be one Soviet military. There are always winners and losers in a situation that is in transformation as the Soviet Union is today.

There were clearly, as early as the late 1970's, Soviet military officers who understood that the challenges facing the Soviet Union on the battlefield in the 21st century would be in microelectronics, in weapons based on—as they call them—new physical principles, in fact lasers; the battle management problems relating to information processing; that that would look like the battlefield of the 21st century, and there were some military officers who were willing to say this was a truly revolutionary circumstance that looked like the replacement of the cavalry with the tank. That was how revolutionary they thought some of these changes on the battlefield might be.

DEFENSE AND THE ECONOMY

There was a growing kind of lack of comfort with whether the Soviet economy could keep up with those demands, both because of its weak technological base and a fear that even if you could get it from the West, it might not fit your own requirements. It was better to have an indigenous technological base for some of these military programs.

Second, a lot of the goods that the Soviet military was beginning to get were shoddy, like everything else from the Soviet economy. It is not true that the Soviets have two separate economies. The military must draw on the same resource base, the same labor base, that the rest of the economy does. They have had priority in getting what they need, but the weaknesses of the economic base and problems in labor productivity were really showing up in Soviet military performance.

MILITARY SUPPORT OF RESTRUCTURING

So among these officers, and I don't wish to suggest that it was the entire officer corps, among these officers it was clear that restructuring the economy or doing something about economic performance was important. They might have hoped that it wouldn't take the form that it may take, kind of decentralization of decisionmaking, but that rather the military model of military efficiency and the command economy with the military at the center of it would be the solution. So I am not certain that they are thrilled with the Gorbachev solution, but that something had to be done about the base of the Soviet economy was clearly understood by Soviet military officers some time ago.

What they will want to see is that there is a payoff, bringing home the bacon, that there is a payoff for Soviet military power fairly soon, and it is really on when that payoff comes to Soviet military power that Gorbachev may find himself at odds with some of his military officers.

MILITARY SUPPORT OF ARMS CONTROL

On arms control, again it is a differentiated picture. On INF, I would argue at least that while there may be some grumbling among the Soviet military that doesn't like giving up any weapons system, giving up the SS-20 is not something that warms the hearts of the marshals, but they can largely cover those targets with ICBM's that are deployed in the Soviet Union.

At the strategic nuclear level, I think it depends in large part on what happens to the strategic defense initiative. They want time. I don't think that they are antidefense. I don't think that they want defenses banned forever, but they want time to stay abreast of the United States; they don't want a major mobilization of the American program and early deployment.

So if they can get an SDI agreement, I think they are more than willing to give up bilateral 50 percent reductions.

Finally, on the significance of some of the moves that we have been seeing with the military, I know it is becoming somewhat vogue to talk about civil-military confrontation between Gorbachev and his marshals, his generals. Sokolov was a very old man. It is at least possible that the military was rather glad to get rid of him and to have a better spokesman.

REPLACEMENT OF SOKOLOV WITH YAZOV

Yazov was probably sixth or seventh in line to become Minister of Defense, so it was something of a shock. But Gorbachev finally went after the Ministry of Defense much in the way that he had gone after the ministries. He is very interested in personnel changes as the basis for his policy changes.

I think what you have seen so far with the military is the removal of a lot of aging commanders, a number of commanders who it turns out were receiving bribes to give deferments in Afghanistan and that kind of thing. So that the personnel changes don't necessarily mean policy differences with the Soviet military.

GORBACHEV AND THE MILITARY

What is a little bit different is that Gorbachev has done it so publicly and I would guess that the military is very unhappy with their public humiliation that he dragged them through after the Cessna affair and the fact that he doesn't sort of suffer the Soviet military in the same way that Brezhnev did, by wearing medals, by putting them on the podium, these are irritants; but I would not yet consider these harbingers of major policy differences between Gorbachev and his military.

Senator **Proxmire**. Congressman Scheuer.

Representative **Scheuer**. Thank you, Mr. Chairman.

SPACE PROGRAM

Ms. Rice, I am a little bit troubled by your statement that there are not Soviet economies. We have learned in our recent unfortunate experience with NASA and the *Challenger* and so forth that there has to be a second American economy as far as our space efforts are concerned.

If we applied the same safety standards and the same inspection standards, the same standard of care and responsibility to space that we do in our production of automobiles, well you can imagine there would not be a space program.

If we didn't have a separate standard and a separate whole infrastructure for space, completely apart from the normal standards of our productive economy which are infinitely higher than Russian standards, we would not have a space effort.

The Russians have undoubtedly had their failures in space. We don't hear about them a great deal, but they have certainly had their successes. They did have a man on the moon and numerous successful launches of space vehicles of all kinds.

And for that, as we have learned to our sorrow, you have to have enormously high standards of accuracy, or care, inspection, and so forth. I am sure you have been to Russia. The standards in practically everything in Russia are almost medieval compared to our society. How can they be successful in space if they haven't said to themselves, if they haven't so created an informal policy in this one area of production, in this one area of economic activity, we are going to shoot for excellence, and the shoddiness and the nonperformance that is endemic in the rest of society simply is not going to be permitted to appear here?

I am not a professional, as you are. I am not an expert, as you are. But it is hard to come to any other conclusion. Now, tell me where I am wrong.

Ms. **Rice**. Let me explain that you are not wrong, Congressman Scheuer. We are both right in this circumstance. The Soviet economy, the resources of which the military and the space program, which are very heavily linked in the Soviet Union, must draw are the same resources that everybody else draws on, the same labor pool, the same basic resources, even the same basic goods that come out—bolts or steel, or whatever.

MILITARY QUALITY CONTROL

Where the Soviet military has had an enormous advantage over its civilian counterparts—and this is also true in space—is that it has had much better quality control. There are stories of military men going down into the plants and demanding that the goods that they get out be very good goods; that it is not the sort of refrigerator that is going to break down next week; that they are absolutely demanding of the people who supply them.

MILITARY AND SPACE PRIORITY

Second, they have had priority for the best of the resources that the economy can produce, so skilled labor tends to be more heavily employed in the military industries than in the civilian industries. When there is a shortage of resources or expense in resources, the military has had a command on those.

What I am describing is exactly what you were describing: a mobilization strategy to military and space which says this is our priority. Now, this was particularly true between about 1965 or 1966 and 1976 when the Soviets were intent on really making great leaps in military power.

We thought that the Soviet military was more efficient in its use of resources. I think what we are learning now is that they were more effective, but not necessarily more efficient, meaning that they got a lot of resources and so they could waste some.

POOR QUALITY OF GOODS

After the 1976–77 period, and some would say that this is why a defense industrialist was appointed Minister of Defense, efficiency became a driving concern for the Soviet military as well. That is when you began to get from the Soviet military officers a lot of grumbling about the quality of Soviet labor, in veiled terms mind you, the quality of goods that were coming out, and stories about things breaking down quite frequently.

So it is not that they didn't mobilize and go after military power, but as the Soviet economy began to shrink and the demand for scarce resources and labor became even greater, the Soviet military began to feel the crunch, too. And that is why I feel at root, they too want to see economic modernization if it is going to benefit them in the long term.

GROWTH IN MUSLIM MILITARY PERSONNEL

Representative SCHEUER. Thank you very much.

Mr. Chairman, with your indulgence, I have one more question.

We hear from time to time—I think there is a professor up at Havard who espouses this theory—that the Soviet Union is going to have a tremendous traumatic experience in the generations ahead due to the growth of their non-Russian population, their Asian population. And they speculate or they project that in a decade or two, 40 or 50 percent of the new draftees in the Soviet Army are going to be Muslims from Central Asia, and that the Russian military has not made any attempt whatsoever to develop a Muslim officer corps.

Right now, there is some question whether the Soviets trust their Muslim draftees enough to give them loaded weapons. They don't know which way they are going to point those weapons.

How do you appraise all of that? Is that a real likelihood in decades to come, or are these people really whistling Dixie?

Ms. RICE. I think it is a problem for them in the decades to come, though perhaps not as big a problem as we sometimes tend to state it. They have made some strides and some efforts at developing part of a Muslim officer corps. They actually have kind of affirmative action programs out there for some of the Republics that almost never seem to meet their officer quotas.

But for the first time, I believe it was in this conscript class, the number of Europeans actually dropped under 70 percent of this conscript class, so it is a growing serious problem.

OFFICER CORPS

It comes in three major problems for them and they will have to deal with those differently. On the officer corps level they can attempt to encourage young Muslims to join the officer corps. Though because there is a kind of bedrock Great Russian nationalism in the officer corps, that may cause more problems than it is worth. My guess is that they may turn to a solution that the United States once used, which is to increase the Muslim content of the NCO ranks. That would really take some of the the pressure off because those are the people that deal mostly with training.

They would have to upgrade the image of the NCO in the Soviet Union, which is not very good at this point.

LANGUAGE PROBLEMS

A second problem is language. We read reports from a former chief of the general staff, that a lot of these kids from Central Asia do not speak Russian. The Soviet military, through its main political administration, has been having Russian language clubs and classes out in Central Asia, where the level of Russian language instruction is very much geared to military concerns. That is one way to deal with that problem.

FORCE REDUCTION

One final way—and this may have an implication for American policy—would be to actually reduce the size of the forces. There are some who believe the Soviets cannot continue to populate a 5 million man force for the indefinite future.

Representative SCHEUER. You mean without having it become more and more dominantly Muslim.

Ms. RICE. Exactly. That is right. The birth rate in general is a problem, but after about 1994 it gets better, but it gets better primarily among Muslim populations.

So one strategy would be to make the corps, the elite armed forces, the cadre army, the professional army, smaller and to put some of these Asians into a kind of territorial defense unit. Some of us are beginning to believe that may be, as much as anything, one of the reasons for conventional force reductions.

If you could get the size of the army down some, it would help a lot with this problem, with the demographic problem that they face.

CONTINUED CONTROL BY GREAT RUSSIANS

Mr. Colby. I would only add to that that the demographics are as you say, there is no question about it. But the party is going to work hard on maintaining its authority and on recruiting people within those populations to be the party representatives. The party is going to remain under Great Russian control. There is no question about that in my mind. And it is going to be a form of colonialism.

The British ran India with very few people.

POTENTIAL FOR EASTERN EUROPEAN CRISIS

Mr. Reddaway. I would also like to add a few comments and address the ethnic minority problem as a whole, not just in relation to the Muslims in Central Asia, and to preface my comments by saying that I think it is a potentially very serious problem for the Kremlin.

In the short term, though, I think it is less serious than the Kremlin's problems in Eastern Europe. It is a sort of reflection of those problems. Soviet domination of Eastern Europe, I think, is the issue which creates the biggest nightmares of all for the Kremlin leaders. If you have a Polish-type situation of 1980–81 recurring in one or, even worse, two east European countries at the same time at some point in the future, that to my mind is what the Soviets regard as the sort of most likely serious crisis that might affect them.

Now, the reason why I compare these two situations is that obviously in order for the leaderships in Eastern Europe to generate some sort of dynamism and efficiency in their own societies, they need some sort of autonomy.

MINORITY REPUBLICS

The same thing is true about the minority Republics within the Soviet Union. The Soviet Union is, formally speaking, a federation. It is a federation of 15 sovereign Republics which have voluntarily joined the Union of Soviet Socialist Republics.

The logic of Gorbachev's strategy of getting the Soviet Union moving again, developing initiative from below, should provide greater autonomy in a number of ways to the Republics. But he is rightly afraid that if he does that, the economy is going to get out of the control of the center, and those local economies in the 15 Republics are going to start functioning for their own use, for their own benefit, and the overall all-union, national interests of the Soviet Union will be undermined and neglected. So he is in a real problem there.

MUSLIM SYMPATHIES

As regards the Muslims, I would just like to say that there is a clear and documentable Soviet concern about the sympathy of Soviet Muslims for Islam as a religion and for Islamic governments, and in particular a concern that that sympathy of the Muslims is becoming increasingly related to sympathy for the Afghan rebels. And that is one reason why I personally think that Gorbachev himself would probably like to get out of Afghanistan. But that is a very serious and difficult problem for him and he has a lot of internal opposition. That is my reading of the situation.

EFFECTS OF COMPUTERS

Representative SCHEUER. Let me follow up with one more question, since the chairman is occupied.

The computer. You are talking about the possible breakdown of central control to the various Republics, their concern about losing control of the satellite countries.

Looking ahead 10, 20, 30 years, don't they have a horrendous decision to make on coming into the 21st century, which is the computer century? They can't become a really productive competitive society with the rest of the world without their workers becoming computer literate, without a whole vast economic infrastructure, with pervasive applications of the computer sciences. Their engineering students, their economic students, their entire university cadres are going to be computer literate.

When you become computer literate, it is very hard for the central administration to control information.

Do you have any thoughts on this, that if they make the choice not to make computers they are consigning themselves to a futile state as compared to the rest of the world? If they make the choice to go for it in the computer age, what does this mean for the ability of the Soviet central establishment, the controlling group in Moscow, to control not only their Muslim populations in Asian Russia, but also to control their satellites.

What is the significance of the computer for the next generation?

Mr. COLBY. Well, it is technology as a whole, Congressman Scheuer, too.

TELEPHONING DISSIDENTS

You know, the Soviets put in direct dialing in Moscow and they discovered that enterprising American journalists were calling up dissidents there, so they cut it off.

Representative SCHEUER. Were doing what?

Mr. COLBY. Enterprising American journalists were telephoning from their New York offices to dissidents in Moscow and getting interviews, so they cut it off. Now you have to go through an operator to get the number.

Well, that means that you can't be efficient. I mean if you insist on maintaining that kind of control, you are not going to be efficient in the modern world.

They are going to have to give. They have given in all sorts of ways, things like the tape recorder, things like the airwaves are wide open now. We are rapidly getting to a television situation where those can be intercepted very easily. This is just a fact of technology. It is going on and on. It is going to reduce the ability to run these kinds of countries.

The Japanese discovered that when they closed everything up they fell behind for 300 years. Then they finally opened up and decided to join the modern world again.

So I think that is their problem, their dilemma. They will work their way through it. They will use computers for personnel control as well as to try to control the misuse of them in their terms.

Ms. **Rice**. I would just add briefly that on the use of computers, it is quite clear that this is a problem for them, but computers do allow—down into the society, too, I suspect you will find them using that. I also think it is important to realize it is probably one reason they will never be at the cutting edge of the development of computer technology.

I come from Stanford, the Silicon Valley. The thoughts of people developing software in their garages, I think, are far, far, far too optimistic for the way the Soviet Union will deal with this. It means that they may be for some extended period one or two generations behind the rest of the world, but they will have to open up some.

Representative **Scheuer**. And as they open up, this will affect their ability to control.

Ms. **Rice**. Yes.

COMPUTER LITERACY

Mr. **Reddaway**. Just a final comment. I agree with what has been said. I would just like to put on the record, though, that part of Mr. Gorbachev's economic program is to create computer literacy within the next 5 or 10 years. That is the aim.

But the way that they are going about implementing that aim is very indicative of the sort of problems that he faces. They have been very slow about the program. It is riddled with problems of developing particular models. They appear to be, as one would expect, giving a low priority to efficient personal computers and going much more in the direction of mainframe computers.

The general progress in introducing computers into the schools is extremely disappointing so far and indicates, as one would expect, that this is going to be a very messy and ineffective process, despite the high priority given to it by the political leadership.

Representative **Scheuer**. Thank you, Mr. Chairman.

SOVIET COMPUTER TECHNOLOGY LAG

Senator **Proxmire**. Thank you, Congressman Scheuer.

If I can believe what I read in Fortune magazine and elsewhere, the analyses I have read, the Soviet Union is way, way, way behind us in this particular technological area of computers, further behind us than in any other aspect of technological progress, so far behind that they said 30 years, 35 years behind us. They are operating, in effect, in the 1940's compared to our operation.

I would think that the most fascinating question that you asked about this could change the Soviet economy, it just seems to me that it might not change it because they just might not make the progress in being able to maintain, operate, construct the computers.

Representative **Scheuer.** They can import them from Japan. The question is, will they? Or Taiwan, for that matter.

U.S. TRADE POLICY

Senator **Proxmire.** Let me get into that question with Mr. Colby.

Yesterday the Defense Department indicated the administration's trade policies toward the Soviet Union have not changed since the beginning of the Reagan presidency and are as follows:

1. Conducting nonstrategic trade with the East; that is wheat—not technology—but wheat to advantaged balance.
2. Avoiding subsidizing the Soviet economy through preferential terms.
3. Restricting transfers of equipment and technology which would increase Warsaw Pact military capabilities.
4. Avoiding increased dependence on the Soviet Union as energy or strategic mineral resources.

If you were advising President Reagan or his successor, Mr. Colby, would you suggest any new U.S. policies in view of the changes taking place in the Soviet Union?

Mr. **Colby.** I would think that we ought to apply the change in trade policy that we came to last year or so, which was that we would work much more closely with our COCOM allies on the implementation of a sensible limitation on the shipment of strategic kind of technology to the Soviet Union.

EXPORT CONTROLS

Senator **Proxmire.** You say "sensible." Are you implying that it is too strict now or not strict enough?

Mr. **Colby.** It certainly has been too strict in the situations in which our exporters were barred and French, German, Japanese, and all the rest were free to export. We were not accomplishing anything by that kind of a rule.

If you make a more limited list and get agreement among the other nations to enforce it, then you have got a logical approach. I think that was the move that we made last year, to begin to move in that direction.

I think that the whole trade problem is a very difficult one in the Soviet Union because it is unseemly for us to be sending anything that they can use for their military force against us, and then you get all the arguments that a pencil can be used to add up columns of soldiers, and therefore you can't send them pencils, which is ridiculous.

We got into it on trucks at one point, so we couldn't send trucks, because the army could use trucks and therefore the German and French and all the rest of the trucks went, but ours didn't, which was a ridiculous situation. Plus the fact that in this field, particularly in high technology, what is today sensitive technology is next year's total availability. And you can hardly get them on the lists and enforce them before they are more generally available throughout the world at the modern time.

The way to keep ahead of the Soviet Union is not to hold them back. It is to stay ahead of them, to put our effort into the R&D to build more and more and keep running well ahead. Administratively, it is a nightmare to try to enforce this problem.

OUTLOOK FOR INCREASED SOVIET OPENNESS

Senator **Proxmire**. One other question for you. Is it realistic to hope that a change in the Soviet Union in Gorbachev's policies will lead in the long run to a more responsible and open Soviet regime and one that would engage in less foreign adventurism and less military spending?

Mr. **Colby**. I think it will lead to a regime, if he is successful in his policies, it will lead to less spending on military; yes. They will still be engaged in foreign adventure through the party structure, through politics, through subversion to a degree in some of their areas, and through proxies. This is a part of the Soviet concept of operation that I think they are going to continue.

But it is one that can be countered on our side without major military confrontation because that kind of a contest we can win if we will put the resources into developing the free countries in those areas and outshine them.

The comparison between North and South Korea is stark these days after 40 years, and that is because South Korea has advanced and is now even advancing politically, and North Korea is dead.

Senator **Proxmire**. You see that everywhere—East and West Germany and so forth.

U.S. POLICY

Let me ask you, Ms. Rice, one final question. It is argued by some that the appropriate policy of the United States and its allies toward the Soviet Union should be one of denial. We should strictly limit if not eliminate trade, prevent technology transfers, be very tough and skeptical about any arms agreement, and make no concessions.

This, it is argued, is the way to force further Soviet reforms. What is your view about that type approach?

Ms. **Rice**. I think that it is shortsighted in the extreme to think that way. I think that on the arms control front, there are a number of agreements that may be beneficial to the Soviet Union but they may well be beneficial to us, too, and just because it is good for the Soviet Union doesn't necessarily mean it is bad for the United States.

In that arena in particular, where the military competition drains resources and I think makes us in many ways not very much safer, a prudent policy of modernization of our forces, along with arms control agreements, it seems to me, a perfectly legitimate approach to take.

In the broader sense, when people talk about denial to the Soviet Union, I think they forget how difficult it is to manage a policy of denial in this situation that we talk about, the cold war. We are not at war with the Soviet Union; we are not at peace with the Soviet Union. There will be impulses to trade with the Soviet Union from our very diverse society.

We saw this with the grain deal where agricultural interests want very much to have that market and where security concerns may have dictated that we not do that. But we have to remember this is a very diverse society with diverse interests and they are going to conflict from time to time. So I don't think we can manage a policy of denial very well.

Finally, whether or not it would really ultimately bring change in the Soviet Union or just a Soviet Union that became again more insular, more in a garrison state mentality, is at least an open question. I guess I would argue that a Soviet Union that faces the prospect of being shut out of the international system, having no stake in it, will be a more dangerous adversary, not one that is cowed.

We have seen under the Stalinist regime an extraordinary ability to mobilize resources, sometimes over the dead bodies of peasants who were starved to death, and famines to support that industrialization drive. This is a society that can mobilize resources to do really amazing things in the defense sphere.

I think it both underestimates the ability of the Soviet leadership to extract resources when it is threatened and overestimates the ability of this more open, diverse society to extract resources from itself.

So I would rather see us take the moderate course.

Senator PROXMIRE. Ms. Rice, Mr. Reddaway, Mr. Colby, thank you so much for really a superlative testimony. We are in your debt. I think you have made a fine record this morning.

We will reconvene on Monday, first in a closed session at 9:30 with the CIA and DIA testifying, and then about 10:30 or 11:00 we will have Ed Hewett of the Brookings Institution, Gertrude Schroeder of the University of Virginia, and Joseph Berliner of Brandeis.

Thank you very much.

[Whereupon, at 11:55 a.m., the subcommittee recessed, to reconvene at 9:30 a.m., Monday, September 14, 1987.]

ECONOMIC REFORMS IN THE U.S.S.R.

MONDAY, SEPTEMBER 14, 1987

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON NATIONAL SECURITY ECONOMICS
OF THE JOINT ECONOMIC COMMITTEE,
Washington, DC.

EXECUTIVE SESSION (CLOSED HEARING)

The subcommittee met, pursuant to recess, at 9:35 a.m., in room SD-628, Dirksen Senate Office Building, Hon. William Proxmire (chairman of the subcommittee) presiding.

Present: Senator Proxmire and Representative McMillan.

Also present: Richard F Kaufman, general counsel.

OPENING STATEMENT OF SENATOR PROXMIRE, CHAIRMAN

Senator PROXMIRE. The subcommittee will come to order.

Today we will hear from the Central Intelligence Agency and the Defense Intelligence Agency.

The subcommittee has had a long and fruitful relationship with two intelligence agencies, going back to 1974, when we instituted annual hearings to receive closed door testimony on Soviet economic development.

In all those years, I'm happy and proud to note, there has not been a single leak of classified information. We've operated in an atmosphere of mutual interest and mutual trust.

We close these sessions so that classified information can be freely discussed, and I'm sure that everyone present today understands the necessity for upholding the strictest security standards and the utmost discretion.

Of course, the testimony will be sanitized and released in unclassified form.

The two prepared statements to be presented are already in unclassified form and will be released immediately following this session.

Spokesmen for the CIA are Douglas Whitehouse and Robert Blackwell, and for the DIA, John Berbrich and Jerome Weinstein.

I would like each Agency to present about a 10-minute oral presentation, so that the remaining time can be used for questions.

Of course, the full prepared statements will appear in the transcript.

After we have completed this portion of the hearing, there will be testimony from three private experts, whom I will introduce later.

Gentlemen, you may proceed.

STATEMENT OF ROBERT BLACKWELL, NIO/U.S.S.R., CENTRAL INTELLIGENCE AGENCY, ACCOMPANIED BY DOUGLAS WHITEHOUSE, CHIEF, ECONOMIC PERFORMANCE DIVISION

Mr. **Blackwell.** Thank you, Mr. Chairman. For the record, let me introduce Douglas Whitehouse, who is substituting for Doug Diamond, who is ill today.

I would like to keep my remarks short, since you already have the prepared statement, and I'll concentrate on providing just a little context and some points of emphasis to the prepared statement that you already have.

OBJECTIVE OF REFORM

The U.S.S.R. is in one of those rare periods [security deletion], where it is really trying to reform itself from within.

The objective, of course, is to perfect the system, not actually to change it.

The question is, How much change might we see?

We think the effort to reform is a serious one, not merely old wine in new bottles. It could lead to some significant changes in the way the Soviet system works, but it also could end up being cut short and resulting in rather little fundamental change. One's assessment of whether such change, if carried forward, would be good for us, depends, of course, on the assumptions that you make about it. And in thinking about this, we need to have a sound understanding of what Gorbachev's reform agenda is and isn't.

The objective of Gorbachev's reform agenda is essentially instrumental. That is, he seeks to reverse social, economic, and political trends at home that, in his view, threaten the system or threaten the gains they have fought hard to achieve in the late sixties and seventies and if not corrected, threaten to leave it badly behind the technologically advancing West in the next century.

More positively, I think, Gorbachev believes that both the system and society require modernization and invigoration, if the U.S.S.R. is to remain competitive in the next century.

In this sense, his purposes are directly tied to national security, but I would argue that it's a far broader meaning to this term than simply military power.

The remedies that Gorbachev seeks are essentially radical, at least by his own definition of the term and perhaps probably also by his colleagues' definition of it.

He believes that only radical measures can correct problems that have been long recognized, but ineffectively and half-heartedly treated.

He has hitched his star to the effort of achieving this kind of reform and shown, to an extent few thought possible 2 years ago, that he is willing to use his power to push the country and the party where he thinks it should go.

TRADITIONAL AND REFORMIST ELEMENTS

Perestroika, that is, the reform that he seeks, encompasses both traditional and reformist elements. On the traditional side, it involves discipline and belt tightening within the party, the broader elite and what is often overlooked, Soviet society.

On this latter point, I think one should not assume, as it sometimes is assumed, that the Soviet populace will necessarily be all that enamored with reform. Indeed, there will be a lot of pain associated with it.

Many, in Soviet society, might actually be very uncomfortable with it.

Beyond discipline, however, on the reformist side, Gorbachev also intends, in our view, to delegate considerable economic and political authority downward to increase the scope for private or at least cooperative initiative, and to some extent, relax the more repressive aspects of state control.

In short, he's looking for a halfway house that combines some central controls with greater decentralization and scope for individual activity.

In terms of outlook, the reform process has only just begun, and while we no longer dismiss, out of hand, as I think we used to, the possiblity that there could be fundamental change in the Soviet system, it is still too early to say if Gorbachev's reforms will actually do so.

The changes he has made—glasnost' has had the most dramatic and visible effect in this regard, are still not irreversible.

The changes he is pushing on the economic front are only now being fleshed out and are still to be implemented. But that Gorbachev intends to make major changes, I have no doubt. As long as he remains in power, I think the process of change will continue and will become more fundamental in nature. For him, the objective—economic modernization, social and political revitalization—cannot be achieved without it. The issue then is, can he do it?

PROSPECTS FOR REFORM

On this point, of course, any student of past Soviet efforts with reform should be skeptical. After all, we really have seen other seeming reform attempts made. Perhaps the most recent or major one was in 1965, and then there were a number under Khrushchev. None of these fundamentally changed the system. Many of them, in fact, died on the vine.

But beyond just that kind of skepticism, there are more fundamental reasons to question whether Gorbachev can actually pull off radical reform of the sort that he seems to be calling for. The obstacles to such reforms are immense. Gorbachev's challenge to the status quo has been like an earthquake to the Soviet system. It has produced considerable unease within the elite and society and even resistance in some quarters. And it is no wonder that it has done so. His program threatens careers, institutional equities, the sacred policies of the past, and ideological tenets that have not been questioned since the late 1920's. For some, at least, Gorbachev's agenda threatens to undermine the party's power.

He certainly is not trying to undermine the party's control of Soviet society. But, he is trying to break with certain elements of the Stalinist political and economic infrastructure of the past and to restore some elements of Leninism that Stalin inherited.

The pain associated with what Gorbachev has in mind will, and already has, made many skeptical. Gorbachev will have to muster sustained power for the years to come to keep his reforms on track, to get the desired results and to prevent resistance, bureaucratic foot-dragging and inertia from draining the blood out of the reform effort.

WILL THE REFORMS WORK?

Beyond this question, there is also legitimate reason to wonder whether Gorbachev's reforms will work, revitalizing both the party, society and the economy, even if it is implemented in the way he wants.

I might add, on that point, that would probably require him to push the reform effort even further than we have already seen him do or seen him articulate in his various speeches.

I actually think he will push it further than we yet have in evidence, but even assuming that, there is the question of whether it will work.

Gorbachev's economic reforms, in particular, those concentrating on the industrial sector, are pushing him into largely uncharted waters for a Communist system. It will require years to achieve the results Gorbachev seems to want. Indeed, under the best of assumptions, Gorbachev probably cannot realistically hope to achieve more and sufficient progress toward raising the level of technology, quality, and productivity to the point where the gap with the West is no longer expanding.

Whether that ultimately is enough to sustain the pressure behind the reforms is open to question. Achieving this, of course, would be no small achievement.

On the more positive side, however, I think we have tended to underestimate Gorbachev's ability to push his agenda and the scope and the extent of the agenda itself.

When he took over, no one expected, and I suspect this is also true of his colleagues, that he would come to dominate the party so quickly or that his agenda would entail such radical policies.

At present, despite the risk, he is clearly in charge and has no strong rivals. While he is clearly not an autocrat and needs the support of his colleagues, he seems to be able to get it, and indeed, he seems to have improved his ability to do so.

The agenda he is pursuing, moreover, is at least perhaps for the first time in a long time, addressing the correct issues regarding what the Soviet Union needs to do to improve itself, although, in our view, it is by no means certain that the answers he is going to come up with will be adequate. Nonetheless, the comprehensive and systematic nature of the guidelines approved at the June plenum, as well as the political changes that he is pursuing, to provide the impetus for change, suggest that Gorbachev's program, for all its inadequacies, could succeed, if he keeps up the pressure and keeps working for changes that increase and intensify the reform direction we are now observing. His agenda also benefits from the widespread recognition that something has to be done, that strong leadership is needed, that to return to Brezhnevisms would lead to stagnation and that he alone in the leadership has a program for dealing with the nation's ills.

IMPLICATIONS FOR FOREIGN POLICY

Now in terms of implications for foreign policy, what does all this mean?

First of all, foreign policy has motives of its own beyond his domestic agenda. What we see him doing would be smart under any circumstances. Gorbachev has clearly instructed his minions to play a more active political and diplomatic role and to creatively look for ways to change the image of the U.S.S.R. from "Mr. Nyet" to "Mr. Cooperation."

In this vein, they have altered some longstanding Soviet positions in many areas, including arms control, and I would suspect we may see more of that in their relations with China as well.

There is an evident tendency in Soviet foreign policy to seize the political high ground across the board, perhaps with the exception of Afghanistan, leaving others to pay the price for lack of progress and to appear on the defensive. But I think his domestic agenda is also a factor in his foreign policy. He does need to divert considerable resources for domestic economic investment for a long period to come to have any chance of achieving his objectives. This requires him to continue to hold the growth of military spending down. For now, that is not a major problem, in that most of the programs that they are now working on have been funded already, but in a few years, he will have to make major decisions about future programs and needs. These decisions, in part, will be based on their assessment of the external threat.

ARMS CONTROL

His arms control policy, as well as his foreign policy in general, is designed to show that he can manage and reduce, if possible, that threat, and thus give him more slack for dealing with the economy. Particularly, he wants to constrain the U.S. strategic build up and the strategic defense initiative via the arms control process.

This is essentially a political response and a political means for dealing with what can become something more fundamental.

I don't believe he has to have agreements right now, and indeed, INF, as such, would give him very little, in econcmic terms. But he clearly views that as part of a political arms control process that will eventually lead and perhaps help him get other steps in that process that will have more economic consequences, particularly constraining and getting limits on SDI and strategic offensive programs would be exactly what he would want in that regard.

It is very possible, though, that he may follow up on these initiatives and extend arms control even further, perhaps in ways that would have even more consequences for his own economy and his own military.

It would certainly be very speculative to say what the scope of that would be, but some major initiatives in 2 or 3 years, in the conventional arms control arena would no longer be unthinkable. They could involve cuts in force deployments and other things.

That's still not in evidence. Of course, it would be moves in those directions that would have the most consequences, potentially, for economic resources.

THE INTERNATIONAL ENVIRONMENT

Finally, beyond threat perception and economic motives, he needs a more benign international environment to pursue his domestic agenda.

Whatever one's opinion of the effectiveness of the reforms is and the degree to which they would change the system in some major respect, they are viewed from within as being radical and are already meeting resistance. This resistance would get considerably greater if international tensions were high, strengthening the arguments of those in the leadership, who do not want the process to go as far or as fast.

In effect, you can't pursue the kinds of reforms he's doing at home which do involve changing some of the ways they've operated in the past, which seem to be opening up information flow and to do that in a period when international crisis is high and where his opponents would almost certainly say that this kind of reform is destabilizing, too turbulent, and gives aid and comfort to our enemies abroad. Indeed, he needs a different kind of environment to pursue that policy.

[The prepared statement of the Central Intelligence Agency follows:]

PREPARED STATEMENT OF THE CENTRAL INTELLIGENCE AGENCY

GORBACHEV'S PROGRAM: MOTIVES AND PROSPECTS

I. HIS DILEMMA

By the time Gorbachev became General Secretary, he realized that changing economic, political and social conditions had made the strategy and tactics of the past increasingly anachronistic.

-- The Soviet economy was in the midst of a decade long slump in growth: GNP grew by just over two percent per year in 1976-85. The technology gap with the West was growing, and energy and other raw material costs were rising precipitously.

-- Soviet leaders were increasingly aware of the rising defense burden and its link to the USSR's inability to provide more rapid gains in consumer welfare and to generate high economic growth. We estimate that during the past 10 years, defense accounted for about 15 percent of Soviet gross national product each year--over twice as much as in the United States.

-- Leadership ineptitude and bureaucratic corruption had sapped the vitality of the system and eroded its legitimacy. This contributed to a widespread malaise in Soviet society, reflected in low worker morale, youth alienation, and an increase in materialism, privatism, and ideological cynicism.

- These domestic problems had important foreign policy implications. Above all, Soviet leaders began to worry about the impact of declining growth and the technology gap on the USSR's future military strength, putting at risk Soviet status as a superpower. Also, poor Soviet economic performance resulted in a more niggardly attitude toward pleas for aid from client states and diminished the appeal of the Soviet economic model to the Third World.

II. A NEW PERCEPTION

These problems had been in the making for some time, and Soviet leaders from the Brezhnev period forward had acknowledged their existence. Gorbachev's perception differed, however, in the way he defined the nature and urgency of the problems as well as the scope and intensity of the necessary solutions. He believed that:

- Soviet economic problems were to a large extent of their own making.
  - The system of planning and management was too centralized and clumsy for effective guidance of the increasingly complex and sophisticated economy. He stressed the need for systemic reform--aimed at changing the basic operating procedures of the economy--rather than piecemeal changes grafted onto the old command system.

  - -- The strategy of low investment growth of the recent past and the pattern of investment allocation had been a deterrent to productivity growth.

-- The global challenges of the future, in particular the technological revolution, would not yield to brute force. Technological change depended heavily on greater autonomy in decisionmaking and a system of fine-tuned incentives. Above all, it required an emphasis on quality as well as quantity.

-- New managerial and moral standards--for both party and government leaders--had to be established and generational change effected.

-- The cooperation and support of the masses--from the party elite down to the common working man--were essential to getting the economy moving again and to regain regime legitimacy. Yet the party must remain in ultimate control.

-- Reduced tension in international relations, particularly with the West, was essential to provide the breathing space for redistributing resources toward the civilian economy and acquiring the necessary foreign equipment and technology as well as for promoting a positive political climate at home for his reform program.

Unlike his predecessors, Gorbachev also realized that these problems were interrelated, requiring a simultaneous assault, that the hard solutions could no longer be avoided, and that the window of opportunity for attacking many of these issues was relatively small. He conveyed a sense of urgency in getting started but at the same time understood that his program was long-run and would not yield immediate gains. In short, Gorbachev could be called a pragmatic visionary.

III. HIS STRATEGY

Gorbachev's strategy for change was molded by these new perceptions.

Growth and Modernization

Gorbachev is pursuing a "human factors" campaign that aims at quick returns from enforcing greater discipline and instilling more initiative in workers and managers and a modernization program designed to update the country's antiquated industrial base over the longer term. The modernization strategy includes:

-- a doubling of retirement rates for fixed capital during the current five-year plan (1986-90), which will replace up to one third of the country's plant and equipment by 1990;

-- an increase in the level of investment in the civilian machine-building and metalworking ministries (MBMW) by 80 percent during 1986-90 over the level achieved during 1981-85; and

-- a program that establishes government quality control inspectors at the plant level (known as Gospriyemka)--similar to procedures used by the military.

Substantial investment in the defense industry in the late 1970s and early 1980s enabled Gorbachev to argue that a larger share of investment in machinebuilding could now go to the civilian sector without seriously affecting defense. Nevertheless, defense and industrial modernization compete for the same scarce, high-quality resources--raw materials, intermediate products, labor and investment.

Cadre Renewal

Gorbachev has made more rapid progress than previous successions in consolidating his power and effecting a large turnover in key positions.

-- He has infused the Politburo with new blood and packed the Secretariat with his supporters (six of the 14 Politburo members are now from the Secretariat). The most recent plenum in June promoted three reform-minded party secretaries to the Politburo. This increase in the number of senior secretaries--members of the Secretariat who have Politburo status--will further dilute the power of "Second Secretary" Ligachev, who appears to be acting as a spokesman for more conservative party members.

-- He has moved to break up entrenched elites in non-Russian areas, particularly Central Asia, and has taken strong steps to rein in regional areas that had drifted away from Moscow's control during the late Brezhnev era.

-- He has purged the ministerial bureaucracy and has brought in new people whom he believes will be more competent and loyal. About two-thirds of the heads of the old economic ministries have been replaced, and nearly all the officials brought in to head the recently created superministries are new.

-- He has expanded Andropov's campaign against corruption, raised standards of performance and probity, and begun an attack on many privileges long enjoyed by officials but resented by ordinary citizens.

Improving Morale and Strengthening the Social Fabric

Gorbachev evidently believes that increased personal freedoms and a freer flow and clash of ideas are necessary to revitalize the system and to overcome widespread apathy and alienation, particularly among the intelligentsia.

His policy of glasnost or openness has resulted in more candor and less ideological rigidity in the discussion of Soviet problems, history, international relations and culture than at any time since the 1920s.

- -- It serves a variety of purposes: it enables the regime to compete with foreign and other unofficial sources of information, it can be used to pillory officials resistant to Gorbachev's reforms, it highlights social problems, such as alcoholism and drug abuse, that need to be addressed, and it appeals to the intelligentsia who had become alienated from regime goals.
- -- The regime clearly intends to place limits on how far glasnost will be allowed to proceed, but just where those limits are to be drawn is not yet clear, and for now the boundaries on public debate are continuing to erode.

The movement toward greater "democratization" is an effort to give the one-party state more legitimacy and the population a greater sense of participation.

- -- Gorbachev has called for multiple candidates and secret ballots in elections of party officials up to the republic level, hinted at procedural changes in the selection of the Central Committee, Secretariat, and Politburo, and scheduled a party conference for next year to revise election procedures.
- -- He has enacted a new Enterprise Law providing for the election

of plant managers, although their election is subject to "confirmation" by superior agencies.

At the same time Gorbachev is attempting to make the system more equitable and to fight social problems.

-- A legal reform is underway that attempts to make the administration of justice more equitable and the use of police power somewhat less arbitrary.

-- In an effort to make creative use of the ideas of dissidents and social critics, some of the worst abuses of human rights have been eliminated and the boundaries of permissible dissent widened; Sakharov has been released from exile and allowed to express his views, more than 140 other political prisoners have been freed, emigration of Jews, ethnic Germans and Armenians have increased several-fold this year compared with last year, and a greater tolerance is being shown toward dissident behavior and public protest.

-- The campaign to fight alcoholism has resulted in a 40 percent drop in legal alcohol sales, and an assault on drug abuse has begun.

Control over the Military

Gorbachev has moved aggressively to assert party authority over the military, whose short-term interests will necessarily be affected by his effort to revitalize the civilian economic base.

-- Since he became party leader, the military has had a less visible public role, exemplified by its reduced representation at major ceremonies.

-- He has beefed up the party apparatus responsible for oversight of the military and reasserted the party's role in the formation of military doctrine.

-- He promoted Lev Zaykov--a close ally--to senior party secretary for defense industry and tightened his personal control over arms control decisionmaking by appointing Eduard Shevardnadze as Foreign Minister and installing a new arms control group in the party's International Department.

-- He used the Cessna incident in June to put his own man in charge of the Ministry of Defense, and there are indications that a broad housecleaning will take place in the months ahead.

-- He has propounded a line stressing "sufficiency" in defense spending and argued that security cannot be attained by "military-technical" means but only through political solutions.

Despite some concern among the military over Gorbachev's policies, most signs point to broadbased military support for the goals of the modernization program, which promises to put Moscow in a better position to maintain its longterm military competitiveness with the United States.

New Initiatives in Foreign Policy

Gorbachev is asserting his authority in the foreign policy area in order to make it more effective and better able to serve domestic needs. He is attempting to maintain Moscow's position internationally by creative diplomacy and arms control while he makes the wrenching and disruptive changes at home.

-- His proposals for nuclear arms reductions are motivated both by the desire to shift some resources from defense to the civilian economy and by the realization that international tensions will strengthen the hand of opponents of reform at home.

-- Beginning with the replacement of Foreign Minister Gromyko, he has carried out a far-reaching shakeup of the foreign policy apparatus, enhancing his personal control over foreign policy decision making.

-- He has increased the foreign policy expertise and responsibilities of the party secretariat, which he heads, and added longtime Ambassador to the US Dobrynin to that body.

- He used this new apparatus to place new emphasis on the manipulation of public opinion abroad to better serve Soviet interests.

IV. HIS BLUEPRINT FOR REFORM

Finally, an integral part of his strategy is his program for economic reform, which is the boldest attempt at a decentralization of economic decisionmaking since Lenin's NEP policy of the early 1920s. Gorbachev justified it by claiming that the economy had reached a "precrisis" stage, necessitating "in depth, truly revolutionary transformations."

He apparently did not have a blueprint for reform from the beginning.

- He started by extending Andropov's and Chernenko's reforms in the industrial sector that reduced and simplified plan indicators and emphasized financing more of an enterprise's expenses out of profits.
- He established a Commission for Improving Management, Planning and the Economic Mechanism in January 1986, which was charged with translating his calls for "radical reform" into a concrete program of legislation and overseeing its implementation.

- -- He sanctioned an unprecedented no-holds-barred debate on economic reform that reached a crescendo just before the Central Committee plenum in June 1987 called to ratify the new reform program.

The evolution of his thinking on economic reform was finally revealed at the June Central Committee plenum, which approved guidelines for the "new economic mechanism" to be "almost fully" implemented by the start of the 13th five-year plan in 1991. Continuing conflict over the reform proposals caused a postponement of the plenum, but Gorbachev called a pre-plenum conference with reform-minded participants to put pressure on the opposition.

- -- With the adoption of these main provisions, Gorbachev replaced his and his predecessors' piecemeal approach to reform with a comprehensive and integrated program.
- -- The "basic provisions" released at the plenum indicate a wide degree of flexibility possible in implementation; the reforms could result in a substantial increase in enterprise autonomy and a partial dismantling of the Stalinist economic model or potentially restrictive clauses could be used to foil this historic attempt at decentralization.
- -- Eleven draft decrees detailing changes in major sections of the economy--including the role of central economic bodies and the

pricing, planning, and supply mechanisms--have just been published (but are not yet available in the West) and may shed more light on how far the reforms will be allowed to go.

The major changes contained in the new reform program touch the heart of the planning and management mechanism.

-- Obligatory plan targets covering an enterprise's entire range of output have been replaced by a system of "non-binding" control figures and mandatory state orders that will comprise only a portion of enterprise output; this portion will reportedly be the bulk of the total at first but will drop gradually to well under half by the 1990s.

-- Prices for the most important products will continue to be set centrally, but the number of prices fixed by the enterprises themselves or contractually with their customers is to be substantially increased; no figures have been released on the dimensions of this increase, however, and even these prices will be set on the same basis as state-set prices and subjected to similar scrutiny by central authorities.

-- Only "scarce" goods are to continue being rationed by the state, and other supplies (as much as 60 percent by 1990) are to be distributed through a "wholesale trade" system, but the critical question of how free an enterprise will be to select its own suppliers remains unclear, and unlike other reform measures (to be implemented by 1991), the transition to wholesale trade is to be completed "within four to five years."

-- Under the new conditions of "self-financing," enterprises are to bear full economic responsibility for their actions, but it is unclear how much discipline will be imposed since the new state enterprise law specifies only that enterprise activities "may" be terminated if an enterprise has a "long record of losses" and only after all measures to correct the situation have failed.

-- In the area of foreign trade, a "stage-by-stage" convertibility of the ruble--the ability to exchange ruble holdings for other currencies--is planned, starting with CEMA countries. The new enterprise law, also ratified at the plenum, reiterates the broader rights of enterprises to keep part of the foreign exchange earned from exports, but the enterprises apparently must seek permission from the ministries to participate directly in foreign economic activity.

These changes in incentives and operating procedures are being accompanied by organizational reforms. By reducing the size and rationalizing the mission of the government bureaucracy, Gorbachev apparently intends to reduce its ability to meddle in the affairs of subordinate enterprises.

- Although the recent reform provisions make no reference to a reduction in the number of ministries, both Gorbachev and Council of Ministers' Chairman Ryzhkov indicated that there are proposals to do so; this process began on 20 July when four machinebuilding ministries were reduced to two. Sectoral sub-branches will also be cut and staff reduced.

- A merger of related ministries and the creation of new coordinating bodies is also being attempted. The agro-industrial reorganization in November 1985 and the new Machinebuilding Bureau, created in October 1985, have not lived up to expectations, however, and the reform provisions call for an "improvement" in their work.

- Gorbachev and Ryzhkov have called for the formation of "state production associations"--amalgams of independent enterprises, production associations, and transport and marketing organizations--as a way of reducing the number of production units Moscow must administer.

Gorbachev's reforms have thus far focused more on the industrial sector than on agriculture.

- This is somewhat surprising since Gorbachev has an agricultural background--he was Brezhnev's agriculture secretary--and soon after becoming General Secretary he began using agriculture as a testing ground for some of his more innovative and controversial ideas.

- -- Reforms in the agricultural sector have been the traditional starting points for reforms in other socialist countries, particularly for the most radical reforms in Hungary and China.
- -- Thus far Soviet reforms in this sector have focused on giving regional officials and farms greater control over the disposal of above-plan production (the March 1986 Decree on Agricultural Management) and expanding the collective contract system and its variant, the family contract.
  - -- The family contract (in which the farm subcontracts some of its tasks to family groups and pays them on this basis) has been vigorously pushed by Gorbachev in recent months, suggesting that he sees this as a way to interject a "proprietary spirit" into collective agriculture.
- -- Gorbachev recently indicated that an agricultural plenum focusing on a wide range of farm issues, presumably including reforms, would be held "in the course of a year."

Reforms enacted since November 1986 to expand the private sector are intended to satisfy demand for consumer goods and services neglected by the state sector and to bring some of the "second economy" under state control.

- Such proposals in the past have encountered opposition from conservatives, who are concerned that a greater role for the private sector will reduce the party's control over the economy and create opportunities for individual enrichment incompatible with socialist principles.

- The new legislation sanctions self-employment in a wide range of activities, permits small groups of people to form profit-sharing cooperatives to engage in consumer-related activities, gives legal sanction to shabashniki--self-employed itinerant construction and farm brigades--and cracks down on "speculation" and "unearned income."

- Regulations on the number and kind of employees--participation is limited to housewives, students, pensioners, and state employees working during their free time--are much more restrictive than comparable legislation in Eastern Europe.

- Thus far the development of the private sector is proceeding slowly because of inadequate incentives, a lack of enthusiasm and support at the local level, and a confusing mass of red tape necessary for licensing and operation.

V. THREATS TO HIS PROGRAM

The fortunes of Gorbachev's program and his own political position will be determined primarily at home, but external developments impinge on all of the decisions Gorbachev might make. In defining the problems as so major and the changes required as so revolutionary, it will be difficult for Gorbachev to be content with "muddling through" as his predecessors did. There are major dangers threatening the success of his program.

First, reform/modernization could cause serious economic disarray.

- Even if the combination of human factors, redirection of investment, and economic reform eventually succeed in reviving Soviet productivity, a period of economic disruption is likely over the next few years.
  - We estimate that this could depress economic growth during the rest of the 1980s to an average annual rate of less than two percent.
  - Industrial growth during the first half of this year, in fact, was only 1-1/2 percent, in large part the result of the introduction of Gospriyemka and the extension of self-financing.
- Such a disruption could severely complicate the delicate balancing of competing interests of institutions, classes, and nationalities.

- -- Gorbachev realizes, for example, that the populace will judge his policies by the "practical improvements in the working and living conditions of the millions." Slow growth would delay such improvements, thereby weakening the ability of the regime to reward those who worked harder.

Secondly, there might be little pay-off evident from his program to boost technological development.

-- Systemic and structural improvements in the economy, if at least partially successful, will stimulate an acceleration in economic growth only in the next decade, and even then, prospects for narrowing the technology gap with the West are slim.

-- Pressures to see some pay-off will mount as the next five-year plan (1991-95) drafting period approaches, particularly from those impatient with the slower growth in military spending.

-- This might generate a new battle between those who would press for increased imports from the West to compensate for domestic shortfalls and others who argue that such imports stifle domestic S&T and encourage dependence on foreign sources for technology.

-- An equally contentious decision might be to scale back some output targets to encourage innovation. The traditional Soviet approach has been to maintain pressure on workers, managers, and bureaucrats; Gorbachev vigorously defended this policy at the June plenum.

In another scenario, his program could be damaged if little progress resulted from arms control and the West sharply boosted defense spending.

-- The strength of military support for industrial modernization coupled with constraints in the growth of defense programs could erode substantially if the external threat assessment becomes darker. Pressures will mount to redirect resources toward defense.

-- It would be impossible to substantially raise defense procurements and fulfill the requirements of industrial modernization at the same time. A sharp rise in the rates of growth of military purchases from the machine-building sector probably would bring the scale of modernization down to the levels of the late Brezhnev years.

-- A more tense international climate probably would also disrupt Moscow's programs for joint ventures and expanded trade and foreclose the possibility of expanding the use of credits to finance import surpluses.

The Soviet leadership will also be looking carefully for signs of domestic instability and/or major power loss by the party caused by new freedoms extended to Soviet citizens and major revisions in the social contract.

-- Party conservatives are already fighting a rear-guard action against glasnost and the relaxation of controls over literature and the theater. Even supporters of greater openness in Soviet society recognize its risks. On the other hand, a crackdown would risk killing the esprit Gorbachev wants to foster and might lead to greater popular cynicism than existed before.

-- Elections inevitably evoke the specter of factionalism that would undermine the top-down direction of the society and the economy that has prevailed for 60 years. No doubt the leadership will do its best to control the election progress, but success is by no means assured.

-- The fear of public disorder is central to the Russian character. Reforms inevitably produce centrifugal tendencies intensifying divisions in society and the elite that could threaten the loss of control and order. Major demonstrations that get out of hand--such as last year's riots in Kazakhstan--are a case in point.

-- Many Soviet citizens already feel their job security threatened and their personal lives constrained by Gorbachev's labor and social policies. A tougher work ethic and stricter discipline are straining relations at the workplace between high performers who stand to gain and low performers who stand to lose.

Setbacks in foreign or domestic policy could cause powerful interest groups to unite against him--the fate that befell Khrushchev, the last party leader who tried to shake up the system.

- -- Gorbachev's attack on the Moscow party organization nearly led to a rebellion in the ranks, demonstrating the risks of moving forceably.
- -- Gorbachev is particularly vulnerable on the security issue.
  - -- Some senior members of the leadership appear to view Gorbachev as too optimistic about his ability to control US military programs through arms control and may prefer increasing nearterm military spending to compete.
  - -- Indicative of policy differences within the leadership over this issue was the January Central Committee resolution that called for more resources to strengthen defense as opposed to Gorbachev's focus on the need for efficiency and discipline among military personnel.

Finally, his economic reform program faces serious obstacles.

- -- Many bureaucrats are increasingly concerned that the changes Gorbachev has proposed will undermine their traditional privileges and status and will work hard at frustrating implementation.

-- Popular resistance to the reforms might coalesce among those who fear that pay tied closer to performance and the elimination of subsidies on many consumer goods and services will lower their standard of living.

-- Ambiguities and contradictions in the reform guidelines approved at the June party plenum indicate that many critical details are yet to be negotiated.

    -- The major issue left unresolved is a tightly defined division of responsibilities between central authorities and the enterprise. The ministry appears still to be held ultimately responsible for the production of its branch subordinates and is charged with "monitoring" their activities.

-- There is still a basic conflict between taut output goals and the emphasis on quality and innovation in the reforms, although some in the leadership have begun to speak publicly about the need to downplay quantitative targets.

-- There is no guarantee that when the reforms are in place, the decisions taken by the enterprises will coincide with national planning objectives; in the past, such a disconnect resulted in a gradual erosion of enterprise authority.

-- The complexity of programming such a massive transition to a new and unfamiliar order, particularly when different parts of the system will be implemented in different stages, will present a formidable challenge.

Nevertheless, there are good reasons why Gorbachev's "new economic mechanism" seems to have a better chance than previous reforms to be implemented with some success.

-- It is a bolder attempt to change the Stalinist system and imposes shorter deadlines.

-- It is a comprehensive package affecting all of the necessary component parts--e.g., supply system, prices, credit and finance.

-- Leadership commitment is at an all-time high because of a recognition of the severity of Soviet economic problems, in particular the technology gap with the West.

-- Some machinery to monitor implementation is in place; Gorbachev told the Central Committee that the Politburo and Secretariat had erred in the past but were now regularly examining the implementation of decisions.

The next several years will be a time for translating general policies into specific directives and for taking evasive actions to avoid the obstacles listed above. Outside of the agricultural area, Gorbachev is not likely to initiate in this time period additional major reforms.

- -- Because the whole reform package is not scheduled to be in place before the early 1990s, and there is likely to be some slippage in this schedule, it will take some time to know if the reforms are a success or failure; both Gorbachev and his critics probably will be willing to wait for results before proposing alternatives or major amendments.
- -- Exceptional events, however, could change this scenario:
  - -- A serious stagnation in growth that was directly reform-related and that lasted a year or more could cause a rethinking about the wisdom of pursuing a reformist course.
  - -- As noted before, international tensions and a breakdown of arms controls or serious domestic unrest could lead to a general repudiation of Gorbachev's policies by conservatives who were always uncomfortable with decentralizing reforms.
  - -- Serious destabilizing unrest in Eastern Europe, resulting

from frustrated expectations for political and economic reforms encouraged by Gorbachev's programs, could strengthen Gorbachev's foes.

All of the obstacles to reform will not be overcome, and the final system in place most probably will be the result of compromise and delay. The new system will not result in market socialism but it could eventually approximate the dual-dependent Hungarian system (greater use of market forces but still subject to many bureaucratic controls), representing some forward movement away from the Stalinist command economy. Even partial implementation probably will bring:

-- Some increase in the quality and assortment of industrial goods and a greater reflection of resource scarcity in producer prices.

-- More and better consumer goods and services, largely the result of the expansion of the cooperative and private sector.

-- A more "rational" distribution of goods and services among the population; demand will play a larger role in consumer pricing, and state subsidies will decline.

-- A greater differentiation in pay and perks that rewards good workers and managers and yields previously untapped increments in labor productivity.

These gains, however, are not likely to match Gorbachev's expectations for his economic program. If Gorbachev is still in power in the mid-1990s when it becomes apparent that his economic reform program has not produced dramatic results, this may be the catalyst that allows him to push for more radical alternatives, particularly if the technology gap continues to widen with the West and threatens the ability of the Soviets to keep up militarily. On the other hand, this could be the catalyst that finally allows his critics to unite and depose him.

Senator **Proxmire**. Thank you, Mr. Blackwell.

Mr. Berbrich, what's your title?

Mr. **Berbrich**. I'm the Vice Deputy Director for Foreign Intelligence of DIA, sir. Mr. Weinstein is an economist, who is part of our organization.

Senator **Proxmire**. Does Mr. Weinstein have a title too?

Mr. **Weinstein**. I'm the Senior Economist in the Warsaw Pact Division.

Senator **Proxmire**. Why don't you go ahead. You have 10 minutes too.

STATEMENT OF JOHN BERBRICH, VICE DEPUTY DIRECTOR FOR FOREIGN INTELLIGENCE, DEFENSE INTELLIGENCE AGENCY, ACCOMPANIED BY JEROME WEINSTEIN, SENIOR ECONOMIST, WARSAW PACT DIVISION

Mr. **Berbrich**. Thank you, sir. I would like to just briefly summarize some of the key points that are in the prepared statement.

GORBACHEV'S PROGRAM IS A LONG-TERM EFFORT

I think, picking up on some of the points that Mr. Blackwell made here, it is essential to keep in mind that Gorbachev's program is, in fact, a very long-term effort. Even though we hear a lot of concentration on the next few years, the next 5-year program, it will probably be 10 to 15 years, if not a generation, before the jury is finally in on the full results of the program.

RECENT MILITARY TRENDS

As a consequence, we can't just look at the short-term results as an indicator of what will finally happen or what program adjustments have to be made in the next couple of years. But recognizing this, we've taken a look at the last 2½ years since Gorbachev has been in power, and with regard to the military programs, the past 2 years have shown us a basic continuation of the trends that we have seen. Force structures are selectively expanding in the military. Equipment levels and units are increasing. Overall military capabilities are also increasing. Sustainability is improving. Military research and development programs are continuing at about the same growth rates as in the past.

We do see greater emphasis being put on accountability, conservation of resources and improving effectiveness, particularly in combat readiness and training. The consistency of the Soviet Union's national security objectives strongly suggests that Gorbachev will take all the steps necessary to ensure the nation's military capabilities, as his reform program evolves over the next several years. Arms control agreements could give Gorbachev some breathing room without sacrificing military capabilities, so he could funnel more resources into the civilian economy and perhaps ease the need to expand the military budget at a faster rate. He could also choose to stretch out some procurement programs or reduce lower priority military programs or activities.

PERESTROIKA IN THE MILITARY

Perestroika, as applied to the military may involve changes in some practices, possible alternatives in force structure or changes in training or manning hours, and increased pressure to conserve resources.

All these changes would not impact negatively in the short run on military capabilities, readiness, or sustainability. In fact, if perestroika were at all successful in its stated goals of increasing combat readiness, improving training and strengthening discipline and order, the result could be a more effective military.

I want to close my brief summary from the prepared statement by stressing two points Mr. Chairman.

First, Gorbachev's program is aimed, as all of his predecessors have sought to do, at ensuring the long-term security of his nation.

CONSEQUENCES FOR THE UNITED STATES

Second, should Gorbachev's program be successful, the United States will be facing a substantially stronger Soviet Union, economically, politically, and military, as we enter the 21st century.

This is a summary of the prepared statement, Mr. Chairman.

[The prepared statement of the Defense Intelligence Agency follows:]

PREPARED STATEMENT OF THE DEFENSE INTELLIGENCE AGENCY

THE ECONOMY AND THE MILITARY

THERE IS A FUNDAMENTAL MARXIST/LENINIST DICTUM THAT HAS TAKEN ON RENEWED MEANING UNDER MIKHAIL GORBACHEV, WHICH SAYS THAT MILITARY STRENGTH IS DEPENDENT ON THE STRENGTH OF THE ECONOMY. WHEN GORBACHEV CAME TO POWER, HE WAS OBVIOUSLY INTENT ON REVITALIZING THE ECONOMY AND MORE IMPORTANTLY ON BRINGING THE SOVIET UNION TO THE FOREFRONT OF TECHNOLOGICAL DEVELOPMENT. HE RECOGNIZED THAT ONLY IN SO DOING WILL THE SOVIET SYSTEM BE ABLE TO KEEP ABREAST OF WESTERN MILITARY TECHNOLOGY AND MAINTAIN ITS POWER AND PRESTIGE. THUS, THE MAJOR CHALLENGE OF THE COMMUNIST PARTY IS TO REVITALIZE THE FALTERING ECONOMY TO ASSURE FUTURE EXPANSION OF ITS MILITARY CAPABILITIES. THE PARTY MAY WELL CONSIDER THE JUNE 1987 PLENUM A PIVOTAL POINT IN SOVIET ECONOMIC HISTORY, AT WHICH THE STAGE WAS SET FOR CHANGES TO BRING ABOUT THE SUCCESSFUL TRANSFORMATION OF THE SOVIET UNION INTO A 21ST CENTURY ECONOMIC POWER.

EVEN AS THE JUNE PLENUM APPEARS TO BE THE HARBINGER OF CHANGE, GORBACHEV ALSO REPRESENTS CONTINUITY IN THE MOST FUNDAMENTAL ELEMENTS OF THE SOVIET UNION. THE SOVIET POLITICAL AND ECONOMIC SYSTEMS CONTINUE TO FOSTER THE GROWTH OF MILITARY POWER.

I THE PRE-GORBACHEV SOVIET UNION

GORBACHEV HAS RAISED THE CONSCIOUSNESS OF THE SOVIET PEOPLE AND THE WORLD TO THE NATION'S ECONOMIC PROBLEMS. BUT THESE PROBLEMS ARE NOT NEW. THEY GO BACK AT LEAST TO THE EARLY DAYS OF LEONID BREZHNEV, WHEN THERE WAS A REALIZATION THAT THE LONG-NEGLECTED INDUSTRIAL BASE HAD TO BE MODERNIZED IF FUTURE MILITARY SECURITY WERE TO BE ASSURED.

-THE MILITARY INDUSTRIAL SECTOR, LONG RECOGNIZED AS THE MOST EFFECTIVE SECTOR IN THE ECONOMY, HAS BEEN REPEATEDLY CALLED ON SINCE THE EARLY 1980'S TO ASSIST THE CIVIL SECTOR, PRIMARILY BY INCREASING ITS OUTPUT OF CONSUMER GOODS. BUT THESE CALLS WERE LARGELY IGNORED.

-HOWEVER, THERE WERE TRANSFERS OF KEY MILITARY INDUSTRIAL MANAGERS TO CIVIL INDUSTRY AND GOVERNMENT POSITIONS.

-DESPITE ECONOMIC PROBLEMS, AS REFLECTED IN THE SOVIET UNION'S LOWEST GROWTH RATES SINCE WORLD WAR II, WEAPONS PRODUCTION IN THE 1980'S CONTINUED AT EXTREMELY HIGH LEVELS, HIGHLIGHTED BY INTRODUCTION OF THE NATION'S MOST SOPHISTICATED AND CAPABLE WEAPONRY. MILITARY RESEARCH AND DEVELOPMENT SHOWED NO SIGNS OF SLACKENING.

IN THE ARMED FORCES, OVERALL TRENDS CONTINUED.

-EVEN THOUGH THE ANNUAL PRODUCTION RATES FOR SOME WEAPONRY SLOWED, THE FORCES WERE GENERALLY ABLE TO CONTINUE BOTH MODERNIZING THEIR WEAPONRY AND EXPANDING THEIR WEAPONS INVENTORIES.

-SO FORCE CAPABILITIES IMPROVED, CONCOMITANT WITH SOME SELECTIVE EXPANSIONS IN FORCE STRUCTURES. KEY SOVIET WAR-FIGHTING PROGRAMS, SUCH AS COMMAND AND CONTROL AND DEEP UNDERGROUND FACILITIES PROGRAMS FOR WAR SURVIVABILITY AND SUSTAINABILITY, CONTINUED TO EXPAND.

II UNDER GORBACHEV

(THE FOLLOWING QUOTE REFLECTS GORBACHEV'S VIEW OF THE CURRENT SITUATION AS OF THIS PAST FEBRUARY.)

> "....IT IS NOW THAT WE ARE AT A CROSSROAD. THE WAY THE SITUATION DEVELOPS FURTHER WILL DEPEND LITERALLY ON WHAT DECISIONS ARE MADE IN THE NEXT 2 OR 3 YEARS. BECAUSE [DEFENSE] IS A LOAD ON THE ECONOMY, APART FROM ALL ELSE BECAUSE IT DIVERTS ENORMOUS RESOURCES THAT COULD BE REDIRECTED, AND IT IS WELL KNOWN WHERE, WE HAVE PLENTY OF PROBLEMS...."
>
> (MIKHAIL S. GORBACHEV, FEBRUARY 1987)

GORBACHEV CLEARLY REALIZED THE NEED FOR PROFOUND AND DRAMATIC CHANGE IF THE TRENDS IN ECONOMIC PERFORMANCE WERE TO BE FUNDAMENTALLY ALTERED. SINCE COMING TO POWER, HE HAS BEEN DEVELOPING A LONG-TERM PROGRAM FOR MODERNIZING THE TECHNOLOGICAL BASE OF INDUSTRY AND RESTORING MORE RAPID RATES OF ECONOMIC GROWTH. THERE WAS ALSO RECOGNITION THAT THE PAST PACE OF MILITARY EXPANSION CLEARLY DETRACTED FROM THE LONG RUN ECONOMIC POTENTIAL OF BOTH THE CIVIL AND MILITARY SECTORS.

-THE PROGRAM CALLS FOR PRIORITIES TO KEY HI-TECH SECTORS OF INDUSTRY (COMPUTERS, ELECTRONICS, MACHINE TOOLS, ETC.) WHICH ARE ESSENTIAL TO SPUR ECONOMIC GROWTH AND IN THE LONG TERM WILL DIRECTLY BENEFIT THE MILITARY. IN FACT, THESE HI-TECH SECTORS ARE THE SAME ONES THE MILITARY HAS URGED BE GIVEN THE HIGHEST ECONOMIC PRIORITY.

-GORBACHEV'S PLANS CALL FOR DRAMATIC CHANGES IN THE WAY THE ECONOMY WILL OPERATE -- MUCH MORE AUTONOMY FOR ENTERPRISES, FEWER DAY-TO-DAY RESPONSIBILITIES FOR THE CENTRAL ADMINISTRATIVE BODIES, AND ULTIMATELY A LARGELY DEMAND-DRIVEN ECONOMY.

-GORBACHEV'S PROGRAM ALSO REFLECTS A NEW CADRES POLICY, WHICH PUTS A PREMIUM ON MANAGERS' ABILITY TO PERFORM, RATHER THAN SIMPLY USING PARTY LOYALTY AS A PRIME CRITERION.

IT IS ESSENTIAL TO KEEP IN MIND THAT THIS IS A LONG-TERM EFFORT -- AT LEAST 10-15 YEARS, IF NOT A GENERATION -- THAT WILL REQUIRE INNUMERABLE SHORT TERM ADJUSTMENTS, MANY OF WHICH WOULD INITIALLY BE DISRUPTIVE AND CONFUSING. SO WE CANNOT LOOK AT SHORT RUN RESULTS AS INDICATORS OF THE LONG RUN.

GORBACHEV'S MODERNIZATION PROGRAM HAS HAD, AND IS TRYING TO HAVE, SOME IMPACT ON THE MILITARY INDUSTRIAL SECTOR:

-MILITARY INDUSTRY CONTINUES TO BE ENTREATED TO DO MORE FOR THE CIVIL ECONOMY; IN PARTICULAR, IMPROVING THE QUALITY OF CIVILIAN OUTPUT, OPERATING MORE EFFICIENTLY, WITH LESS WASTE OF ENERGY AND MATERIALS, AND THEREBY PRODUCING MORE WITHOUT INCREASING THE AMOUNT OF INPUTS.

-THERE HAVE BEEN ISOLATED INSTANCES OF MORE COOPERATION WITH CIVIL INDUSTRY, BUT THERE IS NO EVIDENCE OF MILITARY PLANTS OR PRODUCTION LINES BEING CONVERTED TO CIVIL USE.

-WE CONTINUE TO SEE SOME TRANSFERS OF MANAGERS TO THE CIVIL SECTOR.

-IN ADDITION, A NUMBER OF PERSONNEL CHANGES HAVE OCCURRED SINCE GORBACHEV TOOK OVER. THESE INCLUDE:

- -THE CENTRAL COMMITTEE SECRETARY FOR MILITARY INDUSTRY;
- -THE HEAD OF THE MILITARY INDUSTRIAL COMMISSION (VPK);
- -HALF OF THE MINISTERS IN THE ALL-IMPORTANT MACHINERY - PRODUCING MINISTRIES HAVE BEEN REPLACED.

THESE CHANGES MIRROR THE CHANGES GOING ON THROUGHOUT THE ENTIRE SOVIET SYSTEM.

NOT SURPRISINGLY, THERE HAS BEEN SUBSTANTIALLY LESS IMPACT ON THE MILITARY, AS OVERALL MILITARY POLICY REMAINS UNCHANGED. THERE IS CONTINUED PARTY SUPREMACY OVER THE MILITARY. THE MILITARY, AS IN THE PAST, IS THE IMPLEMENTER, NOT THE MAKER, OF MILITARY POLICY. AND THE MILITARY CONTINUES TO GET WHAT IT NEEDS. WITH REGARD TO MILITARY PROGRAMS, THE PAST FEW YEARS HAVE ALSO SEEN A CONTINUATION OF PAST TRENDS:

- -FORCE STRUCTURES ARE SELECTIVELY EXPANDING;
- -EQUIPMENT LEVELS IN SOME UNITS IS INCREASING;
- -OVERALL, MILITARY CAPABILITIES ARE INCREASING;
- -SUSTAINABILITY IS IMPROVING; AND
- -MILITARY RESEARCH AND DEVELOPMENT PROGRAMS ARE CONTINUING AT THE SAME GROWTH RATES AND WITH ROUGHLY THE SAME NUMBERS OF PROGRAMS AS IN EARLIER DECADES.

THERE HAVE BEEN SOME CHANGES, WHICH ARE CONSISTENT WITH WHAT IS OCCURRING THROUGHOUT THE SOVIET UNION.

-GREATER EMPHASIS IS BEING PUT ON ACCOUNTABILITY, CONSERVATION OF RESOURCES, AND IMPROVING EFFECTIVENESS, PARTICULARLY IN COMBAT READINESS AND TRAINING. MANY IN THE MILITARY PROBABLY DID NOT CONSIDER PERESTROYKA IN THE ARMED FORCES SERIOUSLY. BUT THE CESSNA/RED SQUARE INCIDENT WAS A TIMELY OPPORTUNITY FOR GORBACHEV, WHO USED IT TO ADVANTAGE. BY REPLACING THE DEFENSE MINISTER WITH A STRONG SUPPORTER OF PERESTROYKA, GORBACHEV GAVE A VERY CLEAR SIGNAL TO THE MILITARY THAT RESTRUCTURING IS INDEED TO BE TAKEN SERIOUSLY.

-A NUMBER OF OTHER SIGNIFICANT CHANGES IN MILITARY PERSONNEL HAS OCCURRED:

-INCLUDING THE NEW DEFENSE MINISTER, NINE OF SIXTEEN MEMBERS OF THE HIGH COMMAND ARE NEW.

III THE FUTURE

GORBACHEV'S VIEW OF THE FUTURE PLACES THE MILITARY AS UPPERMOST IN THE LONG RUN.

> "....WE WOULD WELCOME ANY OPPORTUNITY TO SWITCH RESOURCES AND FORCES FROM DEFENSE INTO CIVILIAN SECTORS, INTO INCREASING PEOPLE'S PROSPERITY. BUT WE WILL NEVER SACRIFICE SECURITY INTERESTS...."
>
> (MIKHAIL S. GORBACHEV, SEPTEMBER 1986)

> "YOU CAN REST ASSURED WHEN IT COMES TO DEFENSE. THAT IS POINT NUMBER ONE, AND POINT NUMBER TWO AS WELL."
>
> (MIKHAIL S. GORBACHEV, FEBRUARY 1987)

THE CONSTANCY OF THE SOVIET UNION'S NATIONAL SECURITY OBJECTIVES STRONGLY SUGGEST THAT GORBACHEV WILL TAKE ALL NECESSARY STEPS TO ASSURE THE NATION'S MILITARY CAPABILITIES. THE AMBITIOUS GOALS OF THE MODERNIZATION PROGRAM, HOWEVER, MAY CAUSE COMPETITION IN THE NEAR TERM FOR SELECTED SCARCE RESOURCES -- SUCH AS COMPUTERS, ADVANCED ELECTRONICS AND TOP SCIENTIFIC TALENT. THIS COULD BE INTENSE, INASMUCH AS THESE ARE THE RESOURCES NEEDED BOTH FOR ECONOMIC GROWTH AND FOR DEVELOPMENT OF ADVANCED WEAPONRY.

-ARMS CONTROL AGREEMENTS COULD GIVE GORBACHEV SOME BREATHING ROOM WITHOUT SACRIFICING RELATIVE MILITARY CAPABILITIES, SO HE COULD FUNNEL MORE RESOURCES TO THE CIVIL ECONOMY AND PERHAPS EASE THE NEED TO EXPAND THE MILITARY BUDGET AT A HIGHER RATE.

-HE COULD CHOOSE TO STRETCH OUT SOME PROCUREMENT PROGRAMS OR REDUCE LOWER PRIORITY MILITARY PROGRAMS OR ACTIVITIES.

-PERESTROYKA AS APPLIED TO THE MILITARY MAY INVOLVE CHANGES IN SOME PRACTICES WHICH WOULD SERVE TO REDUCE OUTLAYS:

-POSSIBLE ALTERNATIVES IN FORCE STRUCTURE OR CHANGES IN TRAINING OR MANNING LEVELS.

-INCREASED PRESSURES TO CONSERVE RESOURCES.

-ALL THESE CHANGES WOULD NOT IMPACT NEGATIVELY IN THE SHORT RUN ON MILITARY CAPABILITIES, READINESS AND SUSTAINABILITY. IN FACT, IF PERESTROYKA WERE AT ALL SUCCESSFUL IN ITS STATED GOALS OF INCREASING COMBAT READINESS, IMPROVING TRAINING AND STRENGTHENING OF DISCIPLINE AND ORDER, THE RESULT COULD BE A MORE EFFECTIVE MILITARY. IF GORBACHEV IS SUCCESSFUL IN BOOSTING ECONOMIC GROWTH RATES, WE EXPECT THAT THE MILITARY'S SHARE OF THE RESOURCE PIE IS LIKELY TO REMAIN AT PRESENT LEVELS -- AROUND 15 TO 17 PERCENT OF GNP. HOWEVER, IF THE DISRUPTIVE NATURE OF THE ECONOMIC ADJUSTMENTS PREVENTS GROWTH FROM ACCELERATING, THE MILITARY'S SHARE COULD INCREASE. IN ANY CASE, WE DO NOT BELIEVE THE MILITARY WILL SUFFER ANY DIMINUTION IN CAPABILITIES.

DESPITE THE RESERVATIONS MANY OF THE MILITARY ELITE REPORTEDLY HAVE ABOUT SOME OF GORBACHEV'S PLANS, THE MILITARY, UNDER THE NEW LEADERSHIP OF DEFENSE MINISTER YAZOV, WILL CONTINUE TO SUPPORT THE MODERNIZATION DRIVE. THE MILITARY REALIZES THAT THE TECHNOLOGICALLY SOPHISTICATED REQUIREMENTS FOR FUTURE GENERATIONS OF WEAPON SYSTEMS CAN ONLY BE PROVIDED RELIABLY BY A STRONG ECONOMY WITH A MODERN INDUSTRIAL BASE.

IN CLOSING, I WANT TO STRESS TWO POINTS. FIRST, WE DO NOT BELIEVE THAT MIKHAIL GORBACHEV HAS LAUNCHED HIS MODERNIZATION PROGRAM AND IS PROPOSING RADICAL CHANGE IN THE SOVIET UNION'S ECONOMIC SYSTEM FOR ALTRUISTIC REASONS. HIS PROGRAM IS AIMED, AS ALL OF HIS PREDECESSORS HAVE SOUGHT TO DO, AT ASSURING THE LONG TERM SECURITY OF THE NATION. AND THAT GOAL WILL BE PURSUED VIGOROUSLY, ALTHOUGH WITH SOME DIFFICULTY, SHOULD THE MODERNIZATION PROGRAM NOT SUCCEED. SECOND, AND FINALLY, SHOULD GORBACHEV'S PROGRAM BE SUCCESSFUL, THE UNITED STATES WILL BE FACING A SUBSTANTIALLY STRONGER SOVIET UNION, ECONOMICALLY, POLITICALLY AND MILITARILY, IN THE TWENTY-FIRST CENTURY.

Senator PROXMIRE. Thank you very much, Mr. Berbrich.

GORBACHEV AND THE MILITARY

Mr. Blackwell, your statement described the steps taken by Gorbachev to exercise greater control over the military.

Is he doing this to prevent military spending from rising or to reduce the military goal in decisionmaking, or both, or neither?

Mr. BLACKWELL. Mr. Chairman, I think there are several motives behind it. One is a political calculation that any Soviet leader has to make. He wants to make sure that all the political institutions are very responsive to his political direction.

I think most Soviet leaders in the past have taken steps, eventually, to do the kinds of things that we've seen Gorbachev rather suddenly do and very strikingly, recently.

The second factor, I think, is that during the Brezhnev period, particularly in the last 10 years of it, relations between the party and the military were put on auto pilot.

Senator PROXMIRE. Were put what? I missed that.

Mr. BLACKWELL. Were put on auto pilot. And the strong central direction of the military from the party leadership really was lacking, and Gorbachev is trying to restore a sense of party direction to the military that, by lack of attention, slipped a bit in the late Brezhnev period.

Third, I think these moves relate to his internal agenda.

The military, in principle, is not opposed to the idea of modernization, because, in principle, it should help the military. But the long-term nature of the effort and the fact that the military might have to make some sacrifice for a long period of time probably makes many in the military uncomfortable with Gorbachev's policies.

MILITARY SPENDING

Senator PROXMIRE. In your view, does Gorbachev intend to hold down military spending?

Mr. BLACKWELL. He certainly intends to hold down its growth, for a considerable period of time, if he can do so.

His greatest threat probably does not actually come from the military itself, but it would come from colleagues who may end up saying that because of problems in the international arena, in the nature of the threat facing the country that the country cannot afford to do so.

But if Gorbachev has his way, he will insist on continuing to hold it down and to probably force the military to make difficult choices between some of the things they want to do in the future.

I should add, he probably has not had a whole lot of impact on spending now. The impact he will have on defense spending will be more in the 1990's. Decisions on spending for the mid to late 1990's will have to be made around 1989-90 period, leading up to the 13th five-year plan. Decision in spending then will really impact on defense programs toward the end of the century.

The other places he could have an impact on defense spending would be in the area of conventional arms control, especially if this led in the direction of demobilization of forces. The impact on spending could be more immediate, but we're not there, and I don't think he would be there before 3 or 4 years, at best, assuming he intends to pursue that direction.

ARMS CONTROL

Senator **Proxmire**. Mr. Berbrich, apropos of the last part of part of Mr. Blackwell's remarks, you said arms control agreements could give the Soviet Union and Gorbachev, as you put it, more breathing room.

Does that mean, that from a military standpoint, at least some kind of arms control, at least in the conventional area, might be a mistake?

Mr. **Berbrich**. No, sir. The Soviets approach the whole question of arms control from the perspective of their military objectives. They approach their force development from the clear objective of fulfilling what they see they will need in the event of hostilities. How arms control would contribute to that balance that they would need in the event of hostilities is a factor that goes into their equation. But I do not see that arms control, in and of itself, is a major driver in the Soviet view of their military programs. It is the other way around. The driving force is basic doctrine and strategy, and how arms controls contribute to that in the broader perspective.

Senator **Proxmire**. But to the extent that we would agree, say, to a stringent limitation on conventional arms, including a reduction in troop size and on the number of tanks, planes, artillery, and so forth, this would greatly ease the drain of resources into the military, in the economy, and would allow the Soviet Union to strengthen its economic operations, would it not? In the long run, wouldn't that be likely to benefit them militarily, as well as economically?

Mr. **Berbrich**. If such an agreement came about, in which there were major reductions in conventional arms, they could funnel more resources into other areas of the economy. Whether it would be a net gain vis-a-vis their doctrine and strategy in Europe or Asia, would have to be seen.

STRATEGIC SUFFICIENCY

Senator **Proxmire**. Why did the Soviets move to a doctrine of strategic sufficiency rather than parity or superiority?

Mr. **Berbrich**. Senator, we have been looking at the statements on military sufficiency for some time. We have not yet come to the final conclusion as to what it truly means for the military effort of the Soviet Union.

As you're well aware, sir, over the years, the Soviets have used certain words that seem to describe their programs and activities. For example, in the 1970's, they used the word "parity," and that seemed to describe everything in terms understandable to the West.

Whether this current concept of sufficiency indicates that there's any change, we do not know yet. All I can tell you is that in the past 2½ years, looking at the programs the Soviets have underway, we have seen no adjustments, no changes to their programs across the board in all of their military services.

Senator PROXMIRE. Does that imply that the Soviets might accept something less than parity with the United States on a military basis?

Mr. Blackwell.

Mr. BLACKWELL. Parity and sufficiency are two different concepts, it seems to me.

Senator PROXMIRE. That's right. That's why I'm asking the question.

Mr. BLACKWELL. Two different kinds of concepts.

Parity implies rough equilibrium. I don't think they're going to accept anything other than rough equilibrium.

Senator PROXMIRE. To me, parity implies that they are trying to stay on a par with us, level with us. Sufficiency would seem to me to be to mean that they are trying to develop a military that would be adequate for deterrence and adequate for defense.

Mr. WHITEHOUSE. If I might, Senator Proxmire, it seems to me that over the years, the Soviets have traditionally considered parity to be *x* percent greater numbers of various weapons systems than their opponent. They have felt traditionally, since Stalin's day, that they had to have *x* number of missiles, *x* number of tanks, *x* number of troops more than their opponents.

Senator PROXMIRE. Let me just interrupt to say, isn't the reason for that, that they recognized, No. 1, that their equipment may not be the equivalent of ours, the planes may not be as fast or as maneuverable, or their artillery may not be as accurate, and so forth?

Mr. WHITEHOUSE. In part, sir.

Senator PROXMIRE. And in part, they would have to make up for that in greater numbers. The technology does lag ours, according to what the Defense Department has told us consistently over the last 3 years.

Mr. WHITEHOUSE. That's correct, Senator, in part, that's absolutely true, but there is also a certain, if you will, paranoia about this desire to have a greater number of forces than the enemy. I think that goes back to czarist days, even, but the point is that parity to them, I think, during the 1970's, in particular, was this larger number of forces.

Now what Gorbachev seems to be saying is that reasonable sufficiency implies something that will deter the enemy rather than overwhelm the enemy.

In other words, Gorbachev has come around to realize that it only takes so many nuclear warheads to ensure the total destruction of both societies. You don't have to overwhelm the enemy by millions when thousands will do the job.

Senator PROXMIRE. Yet, at the same time, they've done it. A lot of people would argue—I understand President Carter once asked, why we have to have so many warheads, 200 should do the job, and we have 10,000 and they have 10,000. It seems to me a kind of colossal redundancy on both sides.

HOW LONG WILL GORBACHEV LAST?

My time is almost up, but let me just ask you on this round just one more question. As I understand it, Mr. Backwell, you're saying that there may not be major improvements in the Soviet economy for years. Meanwhile, there will probably be setbacks and disruptions.

Does that mean that Gorbachev will not last? If so, how long will the military and other groups wait before backing a new leader?

Mr. **BLACKWELL**. Tough question.

The reform process has to go on for a long period of time. There will be lots of obstacles, political, economic, and social, to overcome. It inevitably is a disruptive period, and one of the disruptions is the fact that any time a system like this tries to relax a bit, it gets tougher to do so and things tend to get out of control. He will have to guard against unintended effects of his agenda, creating such turmoil within the system that people conspire and work against him to bring him down.

I think the problem, Senator, is that there are lots of good reasons that he could fall, that he could not sustain his political position. Right now he has the momentum and the power to do so, and we don't see him falling, for the present.

There certainly could be situations and conditions that will develop over the next 10 years that would bring him down.

Senator **PROXMIRE**. Do you have an assessment? Will he last? Will he fall? Does the CIA have a judgment on that?

Mr. **BLACKWELL**. If you ask me, will he be around in 5 years?

Senator **PROXMIRE**. Ten years?

Mr. **BLACKWELL**. I think it is probably no better than 50-50 in 10 years. Five years, I think the odds are much higher in his favor. I would say 80 percent, maybe by 85 percent, I would say over the next 2 years, it's probably 95 or 100 percent. But given the nature of his agenda, it is too risky and too radical and too threatening to too many people for him or for us to be able to declare victory for him over the long term.

Senator **PROXMIRE**. Congressman McMillan.

Representative **MCMILLAN**. Thank you, Senator.

On that last remark, I wonder what the KGB would say to Gorbachev about the odds of who is going to be the next President of the United States?

Mr. **BLACKWELL**. They've never done very well about that in the past.

Representative **MCMILLAN**. Haven't they?

Senator **PROXMIRE**. Neither have we! [Laughter.]

PARITY

Representative **MCMILLAN**. Let me just pursue one point the Senator was on a minute ago.

Do we have indications as to whether the Soviets try to define parity, not just in terms of the United States and NATO, but other combinations, of the threats that they may face that involve other forces, perhaps, say, the Chinese, that they would have to face, simultaneously, and to the degree to which that influences their thinking, in believing that they have to be well ahead of what normally is defined as the makeup of the Western alliance?

Mr. **Berbrich**. If I may, just very briefly, sir, when the Soviets look at how they have to fullfill wartime objectives, they do it from a very calculating basis. It's not a mindless approach of simply more nuclear weapons and more tanks. It is very deliberate and calculating.

[Security deletion.]

Also, it's important to emphasize that in all the information that we see, the Soviet forces are fundamentally structured for offensive combat. And as you know, sir, when you are on the offensive, the amount of force that you need to fulfill your objectives is greater than if you're on the defense, just defending an area.

We all fundamentally agree that the Soviet conventional forces in Europe, for example, are far superior in numbers to their NATO allies.

[Security deletion.]

The Soviets do have, in the case of China, a perspective of the possibility of a two-front war, should hostilities ever occur.

You may recall, sir, that it was in the late 1970's when the Soviets created their very first high command of forces in the Soviet Union, since War World II the first theater of high command was created in the Far East. [Security deletion.]

They do, in fact, express tremendous concern over the possibility that they would have to fight a two-front war; however, they have built the forces, placed the command and control and the equipment in the theaters that are needed, so that they could fulfill objectives in either theater, should hostilities occur, and not have to transfer major forces from one theater to another.

Representative **McMillan**. But hasn't the nature of warfare changed, so that what may be even, let's say, a response to what they perceive as an external threat, involve offensive capabilities? In other words, the best defense is a good offense strategy.

Mr. **Berbrich**. Absolutely. Yes, sir.

Representative **McMillan**. Let me shift back to something else.

SOURCES OF GORBACHEV'S SUPPORT AND RESISTANCE

We've said in all these hearings, we tend to focus on the man Gorbachev, yet we don't talk about a lot of his colleagues. That may be a part of the same thrust in the Soviet Union. I find it hard to believe that one man has generated this radical change that we see in process.

I guess the question I want to ask is, to what degree is it dependent on one man, or do we have intelligence that would indicate that there's a broad base of opinion in the Soviet hierarchy that supports what's taking place and whether it's Gorbachev or someone else, this perhaps is a man who is responding to fundamental problems that are widely recognized by enough in the power structure to cause it to happen, or is it one man parachuting out of nowhere, that's all of a sudden come up as the savior of the system?

Mr. **Blackwell**. Certainly not the latter, Congressman.

Gorbachev greatly benefited from the widespread recognition that the stagnation of the Brezhnev period had to end, and in fact that that stagnation was leading the Soviet Union down the road to significant problems in the future, and indeed, that things should have been started while Brezhnev was around to deal with some looming problems, and that just didn't happen.

The failure to do that created even worse problems that required more radical action, when Gorbachev came in. So he benefited from the widespread recognition that something had to be done. To put it in our terms, you have to get the country moving again, both economically, socially, and politically, because the dry rot in the system was very real, and it was far more than just economic. It was social. It was political. It dealt with the party, and it affected even its foreign policy. Something had to be done. And I think particularly, the initial thrust, more discipline, some experiments, some reforms, modest in some respects, had widespread following within the top levels of leadership.

You had to purge the old crowd. You had to bring in new people. You had to revive the discipline, and the authority over the party. You have to shake the system up a bit.

Such an agenda is not that unusual in Soviet history, but I think, increasingly, in Gorbachev's last year, his own agenda became more radical in nature, and he has pushed it a good bit further than that initial impulse for reform would have suggested.

Clearly, he's brought his colleagues with him. It isn't totally dependent on him. At least, he could not have not done it without them. That's what I meant by saying, he's no autocrat. He literally has to be able to convince them, to pull them with him. We know that compromises have been made. You can see it in some of his own speeches. You can see it in the somewhat contradictory nature of some of the reforms, but basically, he seems to have kept pushing it to a good extent.

LIGACHEV

There is resistance, however, on several fronts. In the top part of the leadership, it probably exists and is best personified by the party's second in command, Mr. Ligachev, whom I would characterize as being someone who's basically in favor of the thrust of what is happening, but would want to restrain how fast you do it and how far you take it, and in particular, would limit the nature of the economic reform agenda, would rely on more administrative measures, rather than economic measures and be less inclined to pursue too much decentralization of authority, would be less inclined to allow more market influences to get into the economy.

As regards glasnost', Ligachev basically was on board in favoring that early on, but we've increasingly seen that he is afraid that glasnost' is allowing too much criticism into the system. It is denigrating the Soviet past too much, and it is giving aid and comfort to Soviet enemies.

So he would weaken the thrust of glasnost' and not allow it to go as far; he would put more limits on.

Another kind of resistance that Gorbachev faces is sheer foot-dragging in the bureaucracy, which knows well how to stifle any reform. It requires enormous sustained power to overwhelm that. Any student of the U.S. bureaucracy or any President would probably tell you much the same thing, if they have radical agendas they want to pursue, it is difficult to push it through the bureaucracy.

There's also sheer inertia. This system is 70 years old. It's not easy for any system to change itself, modernize itself from within. It usually requires a sense of crisis of some sort, in order to do that.

I think, to some extent, for the Soviets and Gorbachev, the Brezhnev period helped create some sense of crisis. Gorbachev uses the word "precrisis," conditions that occurred under the Brezhnev era. So he's using that to push it, but it's not a given that he can sustain this effort by himself. He certainly cannot. But the radical nature of the reform agenda is dependent on him. If he loses power, or is thrown out by his colleagues the reform agenda would be significantly damaged. Even if the spearhead of the reform effort is trimmed back, restricted, in places reversed or sabotaged or, in effect, the intent of the reforms reversed to the point that it doesn't mean anything, you would be seeing the very indicators that he is losing effective control of the reform agenda and that the system is coming in around him and putting more constraints on him. He will lose in that context and the reform will die out at some point. It will not reverse all the way to the Brezhnev period, but it could well level off and just sort of go no further.

Some people think that will be what happens. I actually think, so long as he is there, we will see it continue to advance further in areas where it hasn't gone yet.

But, if and when we see the reform effect coming to a halt the hand writing will be on the wall for Gorbachev. That would be my best indicator for the fact that he's likely to lose power.

Representative **McMillan**. Thank you.

Mr. **Weinstein**. Could I add just a brief note to what Bob Blackwell has said?

First of all, I think there are some pluses working in favor of Gorbachev.

First, as Bob Blackwell mentioned, there is a recognized need. I think the debate that we see is focused on the pace of change rather than the need for change. Yes, there is the possibility of bureaucratic resistance, because there will be a lot of losers, but I think there are also some winners in this whole process. Also, Gorbachev has been selecting people for some key positions, not so much on the old basis of party loyalty, much as their ability to get the job done, and the longer he is in place, and the more the capable people he can put in place, the better his chances are for accomplishing at least some of his agenda.

Representative **McMillan**. I believe my time is up, but with the permission of the Senator, go ahead.

YAZOV

Mr. **Berbrich**. I was going to just say perhaps you might find it very interesting how the relationship with Defense Minister Yazov occurred, from what we understand. You may recall in July 1986 Gorbachev presented his major speech at Vladivostok on his reforms and his political agenda for Asia.

Yazov was the commander of the military district of the Far East, of which Vladivostok is the headquarters, at that time.

He apparently impressed Gorbachev very much during Gorbachev's presence in Vladivostok. When Gorbachev went back to Moscow, an opening came on the Ministry of Defense staff. That's when Yazov was picked out of the Far East, brought in as Deputy Minister of Defense for Personnel, not a major position. Important, but not a major one. And then, of course, this past summer, he was elevated to Defense Minister.

So it appears that we know of no relationship between Yazov and Gorbachev in their younger years. It appears that he met him on this occasion and heard of him, obviously, before, was impressed with what the man was saying. The man was either believing it in his heart, or he was saying what Gorbachev wanted him to say, but Gorbachev had that impression that this is a man I want on my team, and he started moving him into a position that eventually brought him into the full team.

GORBACHEV AND MILITARY SPENDING

Senator PROXMIRE. Mr. Berbrich, you say in the prepared statement that Mr. Gorbachev realizes that the past pace of military expansion detracted from long-term economic growth.

Do you mean that he thinks that the military growth rate has been too high at 2 percent per year since 1976 or too high at 4 percent per year before that time?

Mr. BERBRICH. I am going to turn to Mr. Weinstein.

Mr. WEINSTEIN. In our perspective, in looking at the way the current ruble flow has gone, defense spending has been growing faster than the rest of the economy. However it is measured, over whatever time period, the military has received preferential growth, not just in terms of the sheer number or value of the resources going into the military, but in terms of its preferential treatment, getting the best resources, the best scientists and engineers, the best materials, and so forth, all of which has continued to mean that that's less and less of the best available to the rest of the economy.

Senator PROXMIRE. The point is, how do you measure it? Does he want to slow it down from the present pace or the pace that was far faster before 1976?

Mr. WEINSTEIN. Our view is that he would like to contain the pace at current levels.

Mr. BLACKWELL. One thing to add to that is, if you look back in the late 1970's when the slowdown in procurement and other things started, they also started starving their civilian economy for investment. That is, civilian investments really paid the price for even sustaining military growth at the level that they did, as well as keeping the floor under consumption.

When Gorbachev came in, he recognized that you could no longer starve civilian investment the way it had been, that this policy absolutely had to be reversed. That he has done.

For now he can probably do that, but at the same time, something has to give here. He really can't cut consumption too much, because, the fact is, he needs to have some incentive for his populace to work.

NUCLEAR ARMS AGREEMENTS AND MILITARY SPENDING

Senator **Proxmire**. Apropos of that very point, is there any likelihood that the INF agreement or any other nuclear arms agreement, not conventional, but nuclear arms agreement, would substantially reduce Soviet spending and enable him to have greater resources?

Mr. **Blackwell**. Certainly, INF will not. INF, itself, does not have much economic consequence.

Senator **Proxmire**. INF by itself is so much less draining than conventional; when you talk about the effect of an arms control agreement on the economy, are you referring specifically to the conventional?

Mr. **Blackwell**. No, sir. The savings—in just a second, I'll turn to Mr. Abbott sitting in the next row back here.

NEED FOR INF AGREEMENT

Senator **Proxmire**. Before you do that, let me ask this part of the question too.

How important is it to Gorbachev staying in power. We read in the newspapers about how Gorbachev needed that INF agreement. He has to have it just as much as President Reagan, at least as much as President Reagan would like to have it to cap his term as President.

Is your assessment the same? Does he really have to have that INF agreement?

Mr. **Blackwell**. Let me take your last question first. I don't think he has to have an INF agreement right now.

He has made a tactical calculation starting last spring, that an INF agreement was the only thing really possible during the remaining time in this administration; it is the only one where the parameters of the agreement are insight to make it possible to get a treaty in the next 16 months. But he views INF as part of the arms control process. It is the process that he is interested in. He sees INF proceeding to a start and defense and space agreements, although probably not with this administration, but I think he sees it as creating a political environment where the arms control process proceeds. The process is important to him. The timing can slip, and he certainly doesn't have to have it now.

But to go back to what I said earlier, he does need to show, internally, that over a period of time he can manage what they would see as the external threat environment facing the Soviet Union. He needs to be able to show that, politically he can manage this threat of vastly accelerated arms competition or he will have to divert resources from his domestic modernization program back into an accelerated Soviet arms development and procurement program.

INF is a step in helping him do it. It does not really save him much money. It has marginal savings with regard to troop training, equipment, and other things that we don't need to get into here.

If arms control proceeded further, it could provide cost savings or cost avoidance, I would say in the 1990's, not so much in terms of what equipment you can take out of ready status now or you dismantle, but more in terms of what you will not have to spend down the road, in terms of other programs, perhaps to match or to exceed or at least to deal with the things that the United States is doing.

Arms control can make the kinds of program choices that they face in the 1990's easier, and I think that is what he wants to do.

Would you like to add to that, Mr. Abbott?

Mr. Abbott. No. I would pick up, Senator, on Mr. Blackwell's distinction between the arms control process and specific arms control agreements.

I think being able to maintain the current state of the competition between the United States and the U.S.S.R. is very important to Gorbachev. The cost avoidance aspects of arms control are extremely important to him. The specific leverage that he's going to gain from a particular agreement, especially INF, where the investment has already been made in the industrial facility where the programs are well underway, there is not a great deal to be gained there.

CONSEQUENCES FOR THE UNITED STATES IF REFORMS SUCCEED

Senator Proxmire. Mr. Blackwell, the DIA says, if Gorbachev's program is successful, the United States will face a Soviet Union that is stronger economically, politically, and militarily in the 21st century.

Do you agree that such improvements will not occur until after the year 2000 and presumably, the year 2000, the United States will also be stronger economically and militarily, if not politically?

Is there reason why the Soviet Union will gain a greater economic and military strength than the United States?

The Soviet Union's objective is to see that the gap is no longer expanding, militarily, I think, and economically, between the two countries.

Mr. Blackwell. Senator, we are in the speculative realm, when we go out that far. There are obviously going to be differences in the opinion of agencies.

Senator Proxmire. You were telling us how important it was in the long run.

Mr. Blackwell. I am going to answer it. I am also saying that any one of the four of us sitting here could probably give you a somewhat different answer.

My own answer is that there are limits on what the Soviet Union can expect to actually achieve economically, assuming the best assumptions about the way they implement their reform. The best they probably could achieve toward the end of the century is to make sure that the technological and economic gap between the two countries, basically, does not get wider, but it will take some doing to even do this.

Mr. Whitehouse probably can add to that comment, but I think there are other dimensions of the competition that need to have some say in this too.

There's no question that, with a better foreign policy and a more invigorated political system, the Soviet Union can improve itself and can make itself a more formidable competitor to us in certain respects, but we ought to think a little more about what kind of competition that is. I think, in some respects, the competition is entering a much more political realm than simply a military realm. In fact, in the past it has been particularly concentrated on the military side from the Soviet perspective and less on the political.

Gorbachev is giving political factors more of a role in the way he thinks about national security, and I think an invigorated foreign policy and diplomacy is an essential element of this. Simply changing the image of the Soviet Union, internationally, whether it reflects only perception or substance, can carry you a long way. So far, it has been more a matter of image making. I think it may actually become something more than that.

The political dimension of this foreign policy is looming larger in his calculation. In his own thinking about arms control and other things, as he asks his military how much we do this or do that, or could we do this militarily or whatever, I believe he's asking hard questions about the nature of the threat, the nature of the war that may actually come and whether we have to fight it like that or not and other kinds of questions. This gives him some flexibility in the way he approaches the political dynamics of his foreign policy.

THE MILITARY BURDEN

Senator **Proxmire**. Is it your view that Gorbachev intends to shift resources from the military to the civilian sector and a reduction in the military burden?

If not, what do you mean by saying he intends to funnel more resources into the civilian economy?

Mr. **Berbrich**. Arms control agreements could cause him to reduce the amount of growth that has to go into the military.

We see no information at this time, Senator, that Gorbachev has halted the basic programs that are in place for the military and the general scope of their programs over the next 5 years.

As you know well, sir, the Soviets have a very deliberate process by which they develop military equipment for various applications.

There has been no abrupt adjustment of any of this. No change that we have seen. Everything is actually continuing along. As a matter of fact, there have been some abrupt changes outside the Soviet Union, where, for the first time, we see the introduction of very advanced military equipment into areas that the Soviets have never done before.

They are providing some of their most advanced weapons to North Korea and to the Middle East. There are very unusual changes that this man has brought, from a military dimension into foreign policy.

Mr. **Blackwell**. Can I pick up on that just a minute, though? I agree with that. The key, though, for both intelligence and U.S. foreign policy, lies in the kind of resource decisions they have to make in the 1990's that affect the outyears toward the year 2000. Those decisions have not been made. Those are the decisions that are critical to the economic modernization effort inside the Soviet Union.

Those are the decisions that his foreign policy is geared to have an impact upon. His inclination is to hold military spending down.

He needs to ease the choices that he has to make, and he probably would like to constrain some of the programs for his own purposes that he sees coming on his side, if he could do so.

I think his economic agenda makes that important. For now he seems to have focused more on possible savings in strategic weapons and using arms control agreements to do so, but it certainly would help him even more to proceed into the conventional arms control arena.

Senator **Proxmire**. Congressman McMillan.

CONSEQUENCES FOR U.S. POLICY

Representative **McMillan**. I think we are getting on a point we have to focus on.

If the President of the United States would decide that we are spending too much of our resources on defense, he probably wouldn't come out, even in our system and suggest that, that we reduce it to 3.4 percent, and that we reallocate those resources for other purposes.

Here we have a Soviet leader, living under a very established institutionalized military structure that's commanding, what, two to three times, proportionately, the allocation of resources on defense that the United States allocates to defense.

So it strikes me as logical that his initial steps would be rather limited. He has to secure something outside the Soviet Union to justify taking a second step. I don't know that he will take the second step. That would be getting into the perhaps long-range strategic weapons, but more importantly, into the more costly conventional commitments, and I think that would be a real test of whether the Soviet Union is moving in this direction.

I think the question we need to ask is, what sort of policies should we pursue that would accommodate what we think are constructive changes in behavior to our benefit on the part of the Soviet Union? And if, in fact, and I believe this to be true, that to achieve what they want to achieve, technologically, or in terms of economic improvement to the consumer, or in whatever way they define it, they are going to have to allocate resources. They can't tolerate spending 16 to 20 percent of their gross national product on defense.

If that, in fact, is at the root of the change that has taken place, then we need to be in a position to comprehend that and take advantage of it.

To me, that is the critical question.

Mr. **Blackwell**. As you know, Congressman, the intelligence community can't tell anyone exactly what our policy should be. All we can do is try to give you some assessment of what developments and trend lines are and maybe give you an assessment of what we think the Soviet Union is about. It is up to somebody else to make some judgments about what we should do about these trends.

DIVERTING RESOURCES TO CIVILIAN ECONOMY

Mr. **Whitehouse**. Let me add something, though, Congressman McMillan.

We believe that, indeed, as you said, Gorbachev is interested in diverting resources to the civilian economy. The question is why? Is he, as he claims, really overwhelmingly interested in seeing the welfare of the people match that of the United States or the West, or does he recognize full well that the paths of the two major powers, technologically, are diverging so rapidly, that if nothing is done to modernize the system—and you can't just go in and modernize any individual industry, you have to modernize across-the-board—then by the turn of the century, the Soviets will have no hope of competing, either militarily, technologically, or economically.

He wants it both ways, I think. He appears to be, relative to his predecessors, a man of considerable vision, and I think he wants to improve the entire spectrum of Soviet society. But first and foremost, as his predecessors, his greatest concern will be, as ours would be, for that matter, for the security of the country.

His vision tells him that he can't compete with the West if he doesn't do something to change the diverging paths of techological progress that are going on now.

I think his goal is, by the turn of the century, not just to keep the gap from widening, but to narrow the gap. However, I don't believe he's going to be able to do it.

I agree with Mr. Blackwell, that under the best possible circumstances, he could only stabilize it, and that would be doing something. The reason is because you cannot take a society that has operated under a command structure for 70 years and turn it on its head in one or even two 5-year periods. It takes almost generations to do that; certainly decades. That doesn't mean that he won't make progress. I think he will, but technologically he will only make progress in selected areas, because the Soviets do not have the broad-based experience with developing and defusing new technologies that the Western world is accustomed to.

I could give you some specific examples of particular industries, if you like, but I don't want to belabor the issue.

SOVIET TECHNOLOGICAL LAGS

Representative McMILLAN. I had another question. I don't have the time to pursue it.

Senator PROXMIRE. Go right ahead.

Representative McMILLAN. I think specific examples would be extremely useful, to the degree that we can document where they, themselves, perceive themselves as technologically behind.

As many specifics as we have access to, as to how they perceive their shortcomings.

Mr. WHITEHOUSE. I will give you two short ones, just to illustrate the point.

I think I've used these once before. Senator Proxmire may recall them.

Let's take the steel industry, for example. The Soviets were pioneers, some years ago, in developing continuous casting, but they have yet to use continuous casting to the point where it produces a large share of their steel.

They are still using many outdated methods.

Meanwhile, as Senator Proxmire pointed out a little earlier in this session, the West has not stood still. There are technologies in steelmaking being tested today in Western Europe, Japan, and the United States, which will completely transform the way steel is made, in the late 1990's; perhaps even by the mid-1990's. By that time, the Soviets may have progressed to the point where half of their steel is being produced under continuous casting methods which are more efficient than their current methods but they still lag the West, probably by a larger margin than they do today.

Petrochemicals is another area. This brings up an additional point, a sore point to the Soviets. The petrochemical industry in the Soviet Union has developed largely on the basis of Western technology. They have been heavily dependent on the West for fertilizer technology, for synthetic fibers, for many of their plastics. The petrochemical industry is a critical one to modernization throughout the system, including the military. Therefore, they need to develop their R&D sector, which, during the heyday of importing petrochemical equipment from the West, the R&D sector in petrochemicals was allowed to languish.

Now, it is ill prepared to pick up the slack. So they have to redevelop, as it were, the petrochemical R&D sector, in order to be in position to compete at all, let alone close the gap.

I think that by the turn of the century, the Soviets will not have narrowed the gap significantly, except in perhaps one or two areas, and those may be largely dependent on acquisition of foreign technology, either legally or illegally. But for the most part, they will be lucky, if the gap hasn't widened.

LINKING TRADE AND MILITARY SPENDING

Representative **McMillan**. Just one thought that occurs to me. If their needs are technological and economic, and we realize there is an intention, we don't know to what degree they are going to pursue a reallocation of their resources and put them to other purposes. What's wrong with the West taking the position of the Soviet Union, maybe this gets into policy, and you don't want to answer this, but where you are basically getting to a trading posture with them, OK, we will assist you to develop this and that, but in order to do it, the price you are going to have to pay is a simultaneous reduction of force levels in certain areas, and step by step, keeping pressure on the Soviet Union to do. In fact, what we would probably like to see them do.

Mr. **Whitehouse**. I don't know whether anything is wrong with that.

It is a question of what your goals are, ultimately, whether one is more concerned with what Gorbachev might do with the power.

Mr. **Blackwell**. I suspect that direct linkage of that sort wouldn't work diplomatically or politically, although it may, perhaps, by osmosis.

FOREIGN POLICY CHANGES

I think there are a couple of things about his foreign policy, though, that are both good and partly bad for us.

The good news is, he has shown that he is willing to pay a price for certain kinds of agreements that we once thought Soviet leaders would never pay.

He has adopted arms control negotiating positions that, in the past, we never thought we would see.

Whether those are necessarily good or bad is another question, but they are certainly different from what Brezhnev did. I don't think we expected that he would be, in principle, willing to accept 50 percent cuts. We certainly didn't think he would accept the 0–0 INF agreement, when it was proposed in 1982.

Those are both our initiatives, that he has come to accept. I think he is probably prepared to accept even more in that regard. That is why I believe he may eventually become serious about conventional arms control. At present this judgment is mostly speculation, but it has its economic rationale. It also has its political rationale.

All of the political initiatives that he is taking are playing very well. He has managed to effectively seize a lot of the diplomatic and political initiatives on the foreign policy front.

He has managed to effectively change, by image or whatever, the impression that the Soviet Union gives to the world, and that has its impact on its foreign policy, and it helps them, politically.

I expect him to continue that. As a result we face a much more formidable political challenge from this man and from the policies that he is pursuing, because it is going to make alliance management much tougher. We are going to see the Soviets, politically and diplomatically—not necessarily so, militarily—involved in areas, in issues where once they were not involved, whether it be the Middle East, whether it be the Gulf, or whether it be a creative policy in Europe.

These are the kinds of challenges that we are going to have to face, and they are new, and they will challenge our own assumptions about foreign policy and make it tougher.

CHANGING THE SOVIET THREAT

Gyorgy Arbatov, has said that your—the United States—whole alliance and foreign policy is based on the assumptions of the Soviet threat. What are you going to do if we take that away from you? What is going to be your policy for managing your alliance, if that is gone?

Well, I am not saying that the threat is going to go, but the nature of the threat could well be changing in certain respects, and to the extent that the Soviet Union, through diplomacy or arms control agreements or whatever, seeks to diminish the impression of that threat, our problems will get greater and will require more deft political footwork and diplomatic footwork than we have had to exercise in the past.

Representative **McMillan**. Thank you very much.

Senator **Proxmire**. Thank you very, very much, gentlemen, you've done a fine job.

We are deeply in your debt. You have made an excellent record.

We are going to take a couple of minutes off, and so we will have the transition to the open hearing.

[Whereupon, at 10:45 a.m., the executive session (closed hearing) of the subcommittee was concluded. Thereafter, the subcommittee entered into an open hearing.]

Open Hearing

The subcommittee met, pursuant to recess, at 10:50 a.m., in room SD-628, Dirksen Senate Office Building, Hon. William Proxmire (chairman of the subcommittee) presiding.

Present: Senator Proxmire and Representatives Fish and McMillan.

Also present: Richard F Kaufman, general counsel.

OPENING STATEMENT OF SENATOR PROXMIRE, CHAIRMAN

Senator **Proxmire**. The subcommittee will come to order.

I might announce first that the microphones were turned off during the closed session. It might be a few minutes before they can be turned on. So if people will talk loudly, we can hear well. We were able to hear well in the session when they were turned off.

The testimony we have received thus far demonstrates that General Secretary Gorbachev has crossed his Rubicon. He has reached a point of no return in his efforts to reform the Soviet economic system. He may succeed or fail, but in any event the Soviet Union may never be the same again.

One thing we are learning is that it is possible for the Soviet system to change. As the CIA said this morning, Mr. Gorbachev has proposed the most ambitious, comprehensive reforms since Lenin introduced the new economic program in the early 1920's. Of course, the most far reaching of the reforms have not yet been implemented.

The questions asked most frequently are: One, what does Mr. Gorbachev intend to accomplish? Two, is the Stalinist system being fundamentally changed? Three, will the reforms be implemented and, if so, will they succeed? Four, is all of this good news or bad news for the United States?

Our panelists are three senior specialists on the Soviet economy, well known to this committee and throughout the community of Soviet watchers. Each has had a distinguished career of teaching and consulting on the subject of Soviet economics, with numerous if not innumerable publications to their credit.

Joseph Berliner is professor emeritus at Brandeis University and presently associated with the Harvard Russian Research Center.

Ed Hewett is a senior fellow at the Brookings Institution.

Gertrude Schroeder is a professor of economics at the University of Virginia.

Now I am going to call on my good friend, the Congressman from North Carolina, Congressman McMillan, to see if he has a statement.

Representative **McMillan**. I have a written opening statement, Mr. Chairman, that I will just put in the record.

[The written opening statement of Representative McMillan follows:]

WRITTEN OPENING STATEMENT OF REPRESENTATIVE McMILLAN

"CHANGES IN THE SOVIET ECONOMY"

THESE JOINT ECONOMIC COMMITTEE HEARINGS ON ECONOMIC REFORM PROSPECTS UNDER MIKHAIL GORBACHEV HAVE SUPPLIED US WITH FRESH INSIGHTS INTO HOW THE SOVIET UNION IS GRAPPLING WITH ONE OF ITS MOST PRESSING DILEMMAS AS IT APPROACHES THE 21ST CENTURY: HOW TO MAINTAIN AUTHORITY IN A RESTLESS, MULTI-ETHNIC DOMESTIC EMPIRE WHILE SIMULTANEOUSLY ADAPTING THOSE SAME STRUCTURES TO THE PRESSING DEMANDS FOR A MORE RATIONAL ALLOCATION OF RESOURCES. GORBACHEV CLEARLY UNDERSTANDS THE SERIOUSNESS OF THIS DILEMMA AND IS MOUNTING A VIGOROUS EFFORT TO SOLVE IT -- IN A MANNER WHICH ENSURES HIS OWN LONGEVITY. THE INEVITABLE QUESTION FACING HIM -- AND US -- IS WHETHER THIS NEW SOVIET LEADER WILL SUCCEED IN WHAT CLEARLY IS THE USSR'S MOST GIANT UNDERTAKING SINCE WINNING THE WAR AGAINST HITLER IN 1945.

WHAT DOES ALL THIS MEAN FOR THE UNITED STATES? A GOOD DEAL. AT THE OUTSET, WE HAVE AN OPPORTUNITY TO ENGAGE THE SOVIET UNION IN A MANNER WHICH, IF HANDLED CAREFULLY BY OUR SIDE, COULD STRENGTHEN U.S. SECURITY AND MAKE THE WORLD AS A WHOLE A SAFER PLACE TO LIVE IN. AS A GLOBAL SUPERPOWER AND THE LEADER OF THE FREE WORLD, THE UNITED STATES HAS A STRONG INCENTIVE TO NEGOTIATE AGREEMENTS WITH ITS FOREMOST ADVERSARY, PARTICULARLY IN THE ARENA OF ARMS CONTROL, WHICH COULD HELP FREE AMERICAN RESOURCES FOR OTHER ACTIVITIES -- NOTABLY ECONOMIC COMPETITION. ALTHOUGH WE WILL CONTINUE TO SHOULDER THE LARGEST DEFENSE BURDEN IN THE WESTERN

ALLIANCE, THE TIME IS SOON APPROACHING WHEN WE MIGHT HAVE TO SERIOUSLY RE-EXAMINE OUR EXISTING OBLIGATIONS TO OUR JAPANESE AND EUROPEAN ALLIES, WHOSE GROSS NATIONAL PRODUCTS NOW APPROACH OURS.

THE CHALLENGE WHICH HAS BEEN SO ARTICULATELY FOCUSED UPON OVER THESE PAST SEVERAL DAYS IS WHETHER THERE IS ENOUGH FLEXIBILITY IN THE SOVIET UNION UNDER GORBACHEV TO ALLOW THE U.S. TO ADJUST ITS OTHER PRIORITIES. MY IMPRESSION IS THAT MR. GORBACHEV MAY BE MOVING IN A DIRECTION WHICH ALLOWS US TO DO JUST THAT.

AT THIS JUNCTURE, WHAT THE UNITED STATES NEEDS IS BETTER ANALYTICAL INTELLIGENCE ON UNDERLYING TRENDS AT WORK IN THE SOVIET UNION, SO THAT WE CAN MAKE THE KINDS OF HARD-HEADED CHOICES WHICH MR. GORBACHEV IS ALREADY TRYING TO FORCE UPON US. WE SHOULD NOT BE UNDER ANY ILLUSIONS ABOUT THE NATURE OF SOVIET INTENTIONS. IF WE ARE ON THE VERGE OF SEEING A BREAKTHROUGH IN US-SOVIET RELATIONS, THIS IN ONLY BECAUSE MOSCOW BELIEVES IT IS IN ITS FOREMOST INTEREST TO REEVALUATE ITS PRIORITIES; NOTABLY IN THE ECONOMIC ARENA. NEW ARENAS FOR COOPERATION BETWEEN WASHINGTON AND MOSCOW SHOULD NOT LEAD US TO THE FALSE CONCLUSION -- AS IT MAY HAVE IN THE EARLY 1970S -- THAT THE ULTIMATE PURPOSES OF THE SOVIET UNION ARE GOING TO BE DRAMATICALLY REVISED. BUT AS THESE HEARINGS HAVE MADE ABUNDANTLY CLEAR, THERE IS TOO MUCH AT STAKE FOR THE UNITED STATES TO ALLOW US TO IGNORE WHAT MR. GORBACHEV HAS ALREADY ACCOMPLISHED,
AND WHAT THOSE ACCOMPLISHMENTS MEAN FOR FUTURE AMERICAN SECURITY.

Senator **Proxmire**. I would like to ask each of you witnesses to take 10 minutes to summarize your prepared statement. The prepared statements, as I said, will appear in the record of this hearing. We will then have a question-and-answer period.

So, lady and gentlemen, go right ahead. We start off with Professor Berliner, then Professor Hewett and Ms. Schroeder.

Mr. **Berliner**. Mr. Chairman, will the summary appear in the record?

Senator **Proxmire**. Yes. I am going to ask you to take 10 minutes or less, if you will. The full statement will be printed in the record.

Mr. **Berliner**. But the oral summary I give now, will that be in the record?

Senator **Proxmire**. Yes, that will be there also. Both. Yes, indeed.

STATEMENT OF JOSEPH S. BERLINER, PROFESSOR EMERITUS, BRANDEIS UNIVERSITY, AND RUSSIAN RESEARCH CENTER, HARVARD UNIVERSITY

TECHNOLOGICAL PROGRESS

Mr. **Berliner**. Mr. Chairman, one concern dominates all others in Secretary Gorbachev's assessment of the Soviet industrial production. Every Soviet leader from Stalin on has tried his hand at speeding up technological progress. All those efforts, however, have sought to improve the basic Soviet system of central planning. None challenged the system itself, and none were clearly successful.

Mr. Gorbachev's rhetoric encourages the view that here at last was a secretary general wise enough and strong enough to recognize the limits that the traditional Stalinist planning system placed on the performance of the economy.

INITIAL CHANGES

During the first 2 years of his administration, however, the actions of his government did not support that view. Most of the measures that were introduced were of the same kind as had been employed by previous administrations—changes of personnel and so on. There were only two measures that held some promise for moving beyond the efforts of the past. One was the decree authorizing the expansion of private economic activity, primarily in the supply of consumer goods and services. The other was a set of reforms in the foreign trade sector.

JUNE PLENUM

However, these did not constitute a significant change in the fundamental structure of the economic system. At the June plenary meeting of the central committee, however, Mr. Gorbachev sketched a picture of the functioning of the future restructured Soviet economy that does constitute a radical break with the past. If that program of change is implemented, it would then be appropriate to regard central planning as having been effectively abandoned and replaced by a form of market-regulated socialism.

I gather from your introductory remarks that the principal elements of the conception of the future Soviet economy in the June plenum have been elaborated here, so I will assume that those are reasonably well understood. I will therefore go on to questions of implementation and of U.S. interests.

OBSTACLES TO REFORM

It is not a foregone conclusion that that new system envisioned at the plenum will in fact be implemented. It is highly threatening to many groups in the population, including groups with considerable influence, like party officials, ministry personnel, and enterprise management and workers as well.

Opposition to a major change like this is to be expected in any society. What is distinctive about Mr. Gorbachev's U.S.S.R. is the absence of any substantial committed groups with a strong interest in bringing the new economy into existence and making it work.

GLASNOST'

By contrast, things are different in the political and social spheres. Mr. Gorbachev had only to announce the new policy of glasnost', or openness to new ideas, and there was a rush of people ready to take advantage of it. There were writers demanding the publication of suppressed works of the past, Tatars demonstrating in front of the Kremlin for a restoration of their homeland, and so on.

There was a constituency in support of glasnost' that had a deep interest in the success of that policy for which they were willing to take considerable risks. Unfortunately, there is no such constituency, in my opinion, for Mr. Gorbachev's economic system.

COALITION FOR REFORM

The sole constituency for the new economic system consists of some economists, some scientists and liberal intellectuals, some party and military officials who recognize that their country is bound to decline in world affairs as long as the old economic system prevails. It is a constituency of conviction, however, rather than one of material and personal interest.

These are not people whose active cooperation is required to make the reform a success. That will take the commitment of the mass of managerial, governmental, and party officials whose personal interests and ideological convictions still wed them to the system Gorbachev now proposes to eliminate.

OUTLOOK FOR REFORM

How, then, will the reform unfold? In my prepared statement I propose that what will come out of the contest in the committee for drawing up the regulations and the laws that will implement the reform will be a much watered-down version of Gorbachev's vision. What will emerge will be somewhat more decentralized than the system in place when he came into office, but not a new Soviet economic system.

How will that economy perform? My best guess is that it will perform somewhat better than in the past decades. The reasons are that some of the more egregious instances of resource misallocation will probably be modified by the reduction of some subsidies and the dissolution of some enterprises.

With respect to Gorbachev's major objective of accelerating technological progress, I expect that there will be some changes in the domestic economy that will lower some of the traditional barriers to technological progress in the past. For example, if enterprises are able to have somewhat greater latitude in the choice of their suppliers, it will lend somewhat more encouragement to innovation.

One should, therefore, expect some improvement in the quality of Soviet goods and services, and more of them are likely to compete successfully in world markets than in the past. In individual fields under special circumstances, they might well become major competitors. However, there is no reason to expect a qualitative leap in Soviet technological attainment overall.

IMPLICATIONS FOR THE UNITED STATES

If the long-term outcome that I have described here proves to be reasonably accurate, in my opinion the success of Gorbachev's reform is in the interest of the United States. The economic reform is responsible, in part, for recent Soviet contributions toward the reduction in international tensions and toward the conclusion of some arms agreements. The partial liberalization of Soviet society associated with the policy of glasnost', which Gorbachev considers an essential accompaniment of economic reform, extends the range of some of the forms of freedom that the United States seeks to promote. The commitment to raising consumption levels and the popular expectations kindled by that commitment serve as a restraint upon the party and upon the Soviet Government.

The foreign trade reform increases the opportunity to present American views to Soviet citizens, an opportunity normally greatly constrained by Soviet restrictions on the press and upon foreign travel. It also offers productive business opportunities for American firms not only in commercial trade as in the past but also in the novel forms of direct investment and joint production arrangements.

On the negative side, any increase in the Soviet national product eases the economic burden on the political leadership and strengthens their hand in promoting their military and foreign policy objectives. If the success of the economic reform threatened to increase the level of hostility between the United States and the Soviet Union, then I would regard the success of that reform as not in the United States interest.

The contrary is the case at present, however, and is likely to remain so in the foreseeable future. I conclude, therefore, that the benefits to the United States of Gorbachev's economic reform greatly outweigh the negative effect, while recognizing that there is some small risk involved in that assessment.

U.S. TRADE POLICY

Turning finally from the long run to the short run, there are two sets of issues I take up in the prepared statement. One deals with a few of the normal issues of trade, trade between market and nonmarket economies.

I don't go into that very large field, but offer as a general guide to U.S. policy that the U.S. Government should take a neutral stance with respect to all normal commercial dealings between the U.S.S.R. and American business firms and citizens.

By the term "normal" I mean excluding issues of national security and excluding issues of human rights violations. By a neutral stance I mean on the one hand that we should not discourage American business from expanding normal trade in the U.S.S.R. or from entering into joint venture arrangements there. Such business should be regarded as contributing to the U.S. interests in the same way as United States commerce with Yugoslavia, France, India, or Japan is in the United States interest.

On the other hand, a neutral stance also means that we should not offer any privileges in the conduct of that commerce that are not available to other friendly countries, particularly newly industrializing countries. We should not be so euphoric in our new, friendly engagement with the Soviet Government as to overlook our prior interests in the welfare of countries more committed to the political and economic principles we share with them.

OBSTACLES TO REFORM

Finally, we should be prepared to respond to certain events that are likely to occur during the next few years while economic reform is still in the process of working itself out.

In the redesign of so complex a social system as a whole economy, it is inevitable that the parts will not be perfectly articulated on the first try. Shortages of commodities may develop. Production may, therefore, decline for a time in other sectors that depend on those commodities. The possibility will develop of a slowdown in the growth rate or even a decline in output.

These things are likely to occur in a period of some confusion. Those developments should produce considerable domestic turmoil. Events abroad could also erupt unexpectedly, perhaps triggered off by what might appear to be a Soviet Government weakened by domestic turbulence and economic difficulties.

A sharp escalation of international tensions coming at a time of domestic turmoil and economic dislocation could severely strain the Soviet Government's ability to maintain control. It may resort to means of maintaining its authority at home or in neighboring countries that could produce outrage in the United States.

It is not my intention to prophesy doom. My purpose in calling attention to the possibility of turmoil is to alert your subcommittee to the prospect that Gorbachev's reform may precipitate events that could strain United States-Soviet relations in the next few years.

U.S. POLICY

In responding to such events, the interests of the United States would be best served, in my opinion, by steering a middle course. While we have an interest in the success of the reform, we have a more enduring commitment to the promotion of human rights and to the self-determination of nations. If those values are conspicuously violated by an embattled Soviet Government, we should respond in much the same way as we would if there were no Gorbachev or no economic reform.

Unfortunately, there are few effective instruments of U.S. policy that do not impose any costs at all on some of our farmers, industrialists, and workers. To abjure the use of any such instruments is to signal the Soviet Government that there will be no cost to them in their choice of the means of maintaining their authority.

On the other hand, we should reject the counsel to take advantage of the turmoil in the U.S.S.R. to promote our interests. We should, above all, reject the counsel to help that turmoil along for the purpose of destabilizing the Soviet Government in the illusion that the next government will be our grateful friend.

There is no glamour in a policy of the middle course, but it is the wisest that we can pursue in the next few years as Gorbachev's reform unfolds.

[The prepared statement of Mr. Berliner follows:]

PREPARED STATEMENT OF JOSEPH S. BERLINER

One concern dominates all others in Secretary General Gorbachev's assessment of the Soviet economy. It is the unsatisfactory technological level of Soviet industrial production.

That concern is not new. The official reports to Party Congresses as far back as the prewar period contain indictments of the technological performance of Soviet enterprises that are strikingly similar to those pronounced by Gorbachev at the 27th Congress last year. There are two features of Gorbachev's report, however, that differ from those of the past. One is the greater urgency of the language in which he addresses the issue. The other is the greater role he assigns to fundamental systemic causes of the problem, rather than to such causes as incompetent personnel or the poor design of rules and regulations.

A Comparative Perspective. If one looked at the history of Soviet technological development with the eyes of the ordinary Soviet citizen, it is not evident that there is cause for the sense of alarm that Gorbachev conveys. If a prewar manager were miraculously brought back to life today he would be astonished at the technological advance the country has made in the half century. He would be inclined to believe that Stalin's promise to "overtake and the surpass the leading capitalist countries" had actually come to pass. Only if he were aware of the technological level that had been achieved by the most advanced countries would he begin to understand the concerns of the Soviet leadership.

It is the comparative performance of the USSR and not its absolute performance that explains the present urgency. An important British 1977 study of the technological level of Soviet industry found that in the preceding 15-20 years there was no evidence of a "substantial diminution of the technological gap between the USSR and the West." That finding is good news to the Soviets, in a sense. For since Western technology as advanced rapidly during that period, Soviet technology must also have advanced rapidly for the gap not to have widened. It is evident that Soviet socialism has succeeded in designing an economic mechanism for generating a substantial rate of technological advance. It is bad news to the Soviets, however, because if that is the best they can do, they will be continue to be outclassed in that competition. The trouble with the Soviet economy is therefore not the Soviet economy but the economies of the US, Japan, and the other members of that club. If technological advance should cease abroad, there would be no Gorbachev's economic reform, and possibly no Gorbachev either.

What Gorbachev would ideally like to accomplish before he steps down from office a decade or two from now is an economy that produces industrial products of such quality that they could compete with those of any other nation in the industrial markets and consumer shops of New York, Tokyo, Zurich and any other major city of the world. If that were acomplished there would be no further concern about the sluggish rate of economic growth, for the machinery and equipment produced by such an economy would generate a substantial annual increase in the productivity of the economy. There is a sense in which Gorbachev's ultimate objective is an increase in the rate of growth, but the acceleration of technological progress is the key to his strategy for accomplishing it.

Past Efforts At Reform. Every Soviet leader from Stalin on has tried his hand at the game of speeding up technological progress. A great many measures have been employed: organizational changes like the establishment of a powerful top-level State Committee on Science and Technology to direct and coordinate research and development; special monetary incentives for process-and product innovations; new pricing methods to increase the profitability of new products..Some of the measures were of extensive proportions, like the merger of most of the country's enterprises into large "production associations," into which most of the industrial R&D establishments were incorporated, with the objective of better coordination of R&D and production. The major economic reforms of the past, like Khrushchev's total reorganization of the national planning system on territorial rather than on industrial lines, and Brezhnev's 1965 Economic Reform, were designed primarily to improve the general efficiency of the economy, but were also intended to stimulate technological innovation. None of that great variety of measures through all those years, however, was successful enough to produce a significant advance in the country's technological performance.

All those efforts of the past, however, had a certain feature in common. They all fell within the framework of the traditional Soviet system of centralized planning and management of the economy. They were all initiated as ways of improving the operation of central planning system, and not of replacing that system by another.

In retrospect there was good reason in the past to believe that ways could be found to improve the functioning of that system. The nature of the obstacles to innovation were well known and often analyzed in the public press. It did not seem beyond the ingenuity of Soviet economists to design new organizational forms and new rules of procedure that would eliminate those obstacles without violating the basis principles of the traditional centrally planned socialism. Now, however, after half a century of such efforts, it would seem that the burden of proof has now shifted to those who continue to urge that this administration can succeed in finding the key that has eluded all the others. The evidence points rather to the conclusion that the postwar rate of Soviet technological progress is about the best that can be accomplished within the framework of that system. If that is so, then the objective of accelerating technological progress can not be achieved as long as the architects of economic reform are constrained to work within the framework of Soviet central planning.

The Early Gorbachev. Gorbachev's rhetoric encouraged the view that here at last was a Secretary General wise enough and strong enough to recognize the limits that the traditional Stalinist planning system placed upon the performance of the economy. During the first two years of his administration, however, the actions of his government did not support that view. Most of the measures that were introduced were of the same kind as had been employed by previous administrations: changes of personnel, reorganization of ministries and state economic agencies, changes in investment policy, a campaign to raise labor discipline, minor revisions of income incentive systems, and so forth.

There were two measures, however, that hold promise for moving well beyond the efforts of the past. One was a decree authorizing the expansion of private economic activity, primarily in the supply of consumer goods and services. The other was a reform of the foreign trade sector. That reform gives large enterprises and many ministries greater authority to contract directly with foreign firms, instead of having to operate indirectly through state trading agencies as in the past. It also provides for joint ventures with foreign firms, the first reopening of the country to foreign investment since Stalin's accession to power.

It is too early to tell how extensive these changes will prove to be. If they are permitted to expand to substantial dimensions they could make a significant contribution to efficiency and technological progress. However they do not constitute a significant change in the fundamental structure of the economic system, which continues to be based on the centralized planning and management of the predominant portion of the economy. As of June of this year there was no evidence that Gorbachev was prepared to move much beyond the within-system changes that had constrained his predecsssors.

At the June plenary meeting of the Central Committee, however, Gorbachev sketched a picture of a future restructured Soviet economy that does constitute a radical break with the past. If that program of change is implemented, it would be appropriate to regard central planning as having been effectively abandoned and replaced by a form of market-regulated socialism.

A New Economic System. The essence of the new system is that the nation's output would no longer be determined by a detailed national plan that forms the basis of the production obligations of each enterprise. Instead the enterprise would decide for itself what it will produce, on the basis of orders solicited from other enterprises. To obtain the materials, equipment and other requirements for production, the enterprise will no longer submit requisitions to the planning authorities who then specify who the suppliers will be and authorize the deliveries to be made. Instead of that traditional system of "material-technical supply," as it is called, the enterprise must find its own suppliers and place orders with them for its requirements. The suppliers may be either producers of the commodities required or wholesaling enterprises; wholesaling is slated to become a major method of commodity distribution. The state will continue to set prices on basic commodities but all other prices are to be set by negotiation between sellers and buyers.

Producers are expected to compete with each other for sales. The incentive for high levels of production and sales and for economizing on costs is that the net profit may be used in part to increase the incomes of workers and management. Enterprises that fail to cover costs will be reorganized with the assistance of their ministries, but if that does not help they will be dissolved; the permanent subsidation of inefficient economic activity will be gradually phased out.

The State Planning Commission will continue to draw up national plans to be used by the government in the regulation of the main directions of economic activity, such as the rate and structure of investment and the regional distribution of economic activity. The national plans are to serve as a guide to ministries and enterprises but they are to be implemented only by indirect means, including presumably taxes and subsidies, access to bank credit, and the setting of various coefficients (normativy) for the guidance and evaluation of enterprises -- in a manner not yet set forth. The government will acquire the products it needs for military and other purposes by placing "state orders" with enterprises, on a competitive basis. Enterprises must assign top priority to the filling of state orders.

A Turn Tc Capitalism? This new Soviet economy looks very much like that of Hungary, which pioneered in the development of a socialist economy in which state-owned enterprises transact their business in a market-like environment. Popular writers often report reforms of this kind as if the country has finally seen the light and has given up socialism for capitalism. To interpret matters in this way is not merely politically mischievous but can be seriously misleading.

People define socialism in many ways, but most definitions regard the social, or non-private, ownership of the bulk of the productive capital as one of its essential characteristics. That will still remain the predominant form of ownership of capital in the USSR, as it is in Hungary. What will have changed is the way in which these state-owned enterprises transact their business. The central planning of production is the way in which Stalin's USSR managed its socialist economy, but it is not the only way that socialists have had in mind, and to many socialists it has never been the best way, either on economic or political grounds. Democratic socialists in particular have always been hostile to the centralist nature of Soviet socialism, regarding it as an unfortunate heritage of the Russian historical tradition rather than as a necessary feature of a socialist economy. Russia, in their view, gave socialism a bad name. It has indeed been Stalinist policy to insist that central planning of the Soviet variety was the only true socialist way, and to condemn advocates of decentralized and market-like socialism as having abandoned socialism for capitalism. In a curious way, therefore, Western commentators who label Gorbachev's reforms as a turn to capitalism see matters in the same way as Stalin.

Furthermore, to see the reform as a turn to capitalism is to miss the most important lesson that we may one day learn from Gorbachev's reform. If one thinks of socialism as defined primarily by non-private ownership of capital, then Soviet history has not provided a good test of the economic consequences of socialism. The true economic potential of socialism may not have been been realized because it was forced to operate under the burden of central planning, which may be the actual source of the inefficiency of the Soviet economy and its inhospitality to technological innovation. Gorbachev's new Soviet economy will finally provide a test of that proposition. If central planning is finally abandoned, there will be an opportunity to observe, for the first time, the performance of socialism in a large country, unfettered by the bonds of central planning. Socialism will be on trial in a way that it never has before.

Prospects For Implementation. At the present time the new Soviet economy exists only in the resolutions of the June Party Plenum. A series of laws, reported to be in the drafting stage, will have to be issued before the new system can go into operation. The schedule anticipates, however, that the new system will be in full operation by the beginning of the next Five Year Plan in 1991.

It is not a foregone conclusion, however, that the new system will in fact be implemented. It is highly threatening to many groups in the population, including groups with considerable influence. The personal power of Party officials derives in large degree from their traditional responsibility for seeing to it that enterprises fulfill their assigned production targets. If such targets are no longer assigned by the Center and enterprises achieve genuine autonomy over their affairs, the power of Party officials will be greatly reduced. Ministries also lose much of their authority and are specifically scheduled for consolidation and for reduction in the size of their staffs and their budgets. Some enterprise managers and engineers may relish the new responsibilities, but most are likely to fear exposure to competition and to the risks of failure and dissolution -- risks from which they were comfortably sheltered under the old system. Workers above all feel threatened by the possibility of unemployment; and if not that, then assignment to a new job in a new factory, perhaps in a different city. Moreover, under the pressure to economize, the pace of work is likely to quicken and the paycheck will be more responsive to the quality and intensity of labor. We have already witnessed worker hostility to having their pay docked because of sub-quality production.

It is not merely a matter of crass ~~personal~~ interest~~;~~ of putting one's own welfare above that of the country. The mass of Party, government and enterprise officials are not unaware of the deficiencies of the traditional system. They are reasonably patriotic citizens, but they are genuinely concerned that the abandonment of central planning such as Gorbachev now proposes may open the door to disaster. They have never lived in a market-based economy and it is not evident to them that enterprises will be able to obtain the materials and supplies they need if there is no central government agency seeing to it that they are produced and distributed according to some sensible plan. They are concerned about the tensions that can develop in their huge multi-ethnic country if the distribution of production and income is not under firm central control. The fear of anarchy runs deep in Russian political culture. If Gorbachev's radical reform turns out to be one more hare-brained scheme, the Soviet people may be in for a great deal of suffering before the country is once more taken under firm control.

Opposition to reform, however, is not distinctive of Gorbachev's USSR. Every major social change, in any society, encounters opposition from groups with interests vested in the old system or with passionate ideological commitments to that system. Normally, however, there are other groups with an interest in promoting the change, an interest that is sometimes strong enough for people to be willing to sacrifice a great deal to bring the change about. What is distinctive about Gorbachev's USSR is the absence of any substantial committed groups with a strong interest in bringing the new economy into existence and making it work.

Things are different in the political and social spheres. Gorbachev had but to announce the new policy of glasnost', or openness to new ideas, and there was a rush of people ready to take advantage of it. There were writers demanding the publication of the suppressed works of the past, Tatars demonstrating before the Kremlin for a restoration of their homeland, human rights activists demanding the release of political prisoners, Jews demanding the right to emigrate, Lithuanians denouncing the Hitler-Stalin pact of 1939, and more. Gorbachev indeed is under pressure from these groups to go further than he has; the editor of the new unofficial journal entitled Glasnost' is demanding the right to publish without official authorization and without censorship. There is a constitutency in support of glasnost' that has a deep interest in the success of that policy for which they are willing to take great risks.

Unfortunately there is no such constituency for Gorbachev's new economic system. There are no groups beating down the walls and demanding that the barriers to economic activity be lowered so that they can get on with their own work; there are no landless peasants pressing for the confiscation of the latifundia, no merchants and manufacturers demanding the repeal of the mercantilist laws that restrict their commerce.

One might suppose that people who are engaged in the "second economy" would be supportive of Gorbachev's economic program. This includes urban dwellers as well as peasants cultivating individual garden plots and selling their produce under lawful conditions. It also includes craftsmen providing consumer goods and services. They would indeed benefit from Gorbachev's policy of expanding the lawful private sector, but they have no personal interest in his program regarding the state sector; whether the state sector is run by central planning or by decentralized markets is of little practical concern to them. Those engaged in illegal private activity, moreover, would find their income opportunities reduced under the new economic system; if flowers were more efficiently grown and marketed by state farms, there would be fewer Georgian merchants flying up to Moscow with suitcases filled with flowers for illegal sale.

The absence of a constituency reflects the fact that, in all societies, a person's welfare is more affected by his status as a producer than by his status as a consumer; it is for that reason that associations of industrialists and workers are liberally represented in the lobbies of Washington while associations of consumers are rare and weak. It is in their role as consumers, however, that all Soviet citizens will benefit if Gorbachev's new economic system is successful. In their role as producers, however, all face the threat of a decline in their status and in their job security. In countries where even increases in the price of meat or bread have been known to precipitate riots, the popular reaction to the loss of jobs or pay is potentially explosive.

A reform as extensive as Gorbachev now proposes would marshall more political support if the system it supplants had reached the point of breakdown; if the alternative to reform were collapse and starvation. China was approaching that point during the last years of Mao, which made radical reform much more acceptable after his death. Some peasants, in fact, had begun to abandon the communes and turn to their family farms, without central authorization, well before the new government under Deng legislated the demise of the communes and adopted the "family responsibility system." Here was a real constituency for reform, primed to throw themselves into the very activities that the reform was intended to support. Perhaps if circumstances became desperate some such movement might appear in the USSR, but there is no evidence of it at the present time. The paradox is that the Soviet economy performs too well to be ready for large changes.

Thus the sole constituency for the new economic system consists of some economists, some scientists and liberal intellectuals, and some Party and military officers who recognize that their country is bound to decline in world affairs as long as the old economic system prevails. It is a constituency of conviction, however, rather than of personal interest. These are not the the people whose active cooperation is required to make the reform a success. That will take the commitment of the mass of managerial, governmental and Party officials, whose personal interests and ideological convictions still wed them to the system Gorbachev now proposes to eliminate.

Gorbachev may be likened to Peter the Great who forced a recalcitrant

Russia to change its old ways in order to survive as a world power. Peter also had no constituency but a small band of committed followers. All he had was a vision -- and power. Gorbachev has a vision too, but in the complex industrial society of the day he is unlikely to acquire the power that it would take to pull off a successful reform to which no major groups of the population are committed.

The Long Run. How then will the reform process unfold? In considering this question it is vital to distinguish the short run from the long run. It will take several years before all the legislation required to implement the reform will be enacted. It will take several more years before all the bugs in the new system have been detected and eliminated; it is inevitable that in so vast a reform effort some miscalculations will be made and some of the original laws will have to be revised. Throughout this period all economic organizations, some of them only recently established under the reform, will have to learn how to operate under the new rules and under constantly changing conditions.

It is crucially important not to judge the reform by the performance of the economy during this short-run period of adjustment and learning. It is only in the long run, when the economy has settled down to operation under more or less stabilized conditions, that the success of the reform should be judged.

In this section I shall ignore the short run and discuss the prospects for the long-run outcome of the reform, followed by some observations about its implications for US policy.

Forecasting an outcome is hazardous enough under the usual circumstance in which a one portion of an economic structure is changed while most of it operates as before. It is downright foolhardy when the entire structure is to be changed and economic factors are deeply enmeshed in political and social forces. The purpose of this forum, however, demands some speculation on what is likely to transpire. The most cautious way to proceed would be to sketch out a variety of possible scenarios and to assign some rough probability to each. I shall move directly, however, to my own guess about the most likely outcome.

The implication of the preceding analysis is that many of the specific proposals advanced by the radical reformers in the law-drafting sessions will confront strong arguments by their opponents. What will emerge will be compromises; giving greater authority to enterprises to establish their own output program, for example, but holding their ministries responsible for shortfalls in the output of individual products relative to the demand. Most of the laws so enacted will take an enabling form; for example, enterprises will be given the right to compete for the customers of other enterprises. The decision to use those rights fully, however, will be tempered by the sentiments of the Party, ministry and workers. The benefits from aggressive and successful competition may not be as great as the benefits from a comfortable collusion to live and let live.

Some grossly inefficient enterprises may be dissolved here and there but few ministry officials will seek to advance their careers by seeking a reputation for diligence in that distasteful activity. Enterprises will continue to receive production directives from their ministries, perhaps informally as in Hungary. They may obtain a larger proportion of their supplies from wholesale trade organizations but will still be heavily dependent on a centrally-managed materials allocation system as in the past. Ministry control of enterprise decisions by means of stable "normatives" gives management more breathing space than the traditional control by "directives," but they still impose tight bureaucratic constraints on the search for efficient choices among inputs. The national plan will continue to serve as the basis of the evaluation of the ministries and therefore indirectly of the enterprises as well. Within the state sector, in the conduct of foreign economic relations there will be a somewhat greater degree of decentralization. Soviet producers of some goods and services like automotive vehicles and space satellite services will enter markets abroad more aggressively and successfully than in the past, in close joint management with foreign marketing networks. The country will be a more active participant in international economic organizations. The prospects for the private sector, however, are not as bright as one might have forecast a year ago. The new law assigns the administration of the regulations to the local Party and government officials, who have not been known to be enthusiastic about the rise of a class of persons earning incomes much larger than theirs and no longer dependent on their power and beneficence. The potential for corruption, as in the past, is large.

If the reform process does indeed evolve in this manner, what will emerge in the long run is a much watered down version of the new economic system sketched out in the June Plenum. The underlying model of the system would not be altered. It would best be described as a somewhat more decentralized version of the traditional economic system, rather than a radical change in that system.

That economy should perform somewhat better than in the past decade. Some the more egregious instances of resource misallocation will be modified by the reduction of some subsidies and the dissolution of some enterprises. The output of goods and services will be somewhat more efficiently distributed as prices move closer to equilibrium levels. Even the modest expansion of the private sector will provide a palpable improvement in consumer welfare.

With respect to Gorbachev's primary objective of accelerating technological progress, some of the changes in the domestic economy will lower some of the barriers to technological innovation of the past; for example, the greater latitude in choosing one's suppliers, and the opportunity to expand the sales of a new product with less regard than in the past to its effect on competing producers. The direct participation in foreign trade negotiations by many enterprises and ministries should give them a better sense of the quality standards of the world market than they have had in the past. Joint production arrangements could make a contribution in upgrading the quality of Soviet output. The volume and frequency of commercial travel by Soviet engineers and managers should increase; the infrequency of such travel in the past has deprived the Soviets of a vital form of technology transfer from which all other industrial nations have benefitted.

One should therefore expect some improvement in the quality of Soviet goods and services, and more of them are likely to compete successfully in world markets than in the past. In individual fields under special circumstances they may well become major competitors. There is no reason to expect a qualitative leap in Soviet technological attainment overall, however. The modestly changed Soviet economy provides neither the degree of enterprise autonomy nor the powerful individual incentives that drive the innovative process in the most successful countries.

The US Interest. We should be clear that US policy will play a very minor role in the way in which the Soviet reform plays itself out. It will be primarily a matter of Soviet domestic politics and economics, although major events abroad could affect the domestic scene. US policy can play a small role, however, and in playing that role we should be cognizant of where our interest lies.

If the long-run outcome sketched out above proves to be reasonably accurate, in my opinion the success of Gorbachev's reform is in the interest of the US. The economic reform is responsible in part for recent Soviet contributions toward the reduction of international tensions and toward the conclusion of arms controls agreements. The partial liberalization of the society associated with the policy of glasnost', which Gorbachev considers an essential accompaniment of economic reform, extends the range of some of the forms of freedom that the US seeks to promote. The commitment to raising consumption levels, and the popular expectations kindled by that commitment, serve as a restraint upon Party and government.The foreign trade reform increases the opportunity to present American views to Soviet citizens, an opportunity normally greatly constrained by Soviet restrictions on the press and on foreign travel. It also offer productive business opportunities for American firms, not only in commercial trade as in the past but also in the novel forms of direct investment and joint production arrangements.

On the negative side of the balance, any increase in Soviet national product eases the economic burden on the political leadership and strengthens their hand in promoting their military and foreign policy objectives. The more intense the adversarial relationship between the US and the USSR, the more serious this factor must be considered. If the success of the economic reform threatened to increase the level of hostility, I would argue that this negative side should dominate our assessment and the reform should be regarded as not in the US interest. The contrary is the case at present, however, and is likely to remain so in the foreseeable future. I conclude therefore that the benefits to the US of Gorbachev's economic reform greatly outweigh that negative effect, while recognizing that there is some small risk involved in that assessment.

What if the long-run outcome that I have forecast proves to be quite wrong? Economic performance may be stronger than the modest improvement I foresee, or there may be no improvement at all. To sharpen the discussion of the US interest it is useful to consider two hypothetical extremes. At one extreme the reform may be so successful as to realize Gorbachev's vision; the USSR becomes the Japan of the 21st century. At the other extreme, it fails so thoroughly as to lead to the virtual collapse of the Soviet economy. Both extremes, in my opinion, pose great risks for the US. The reason is evident in the first case; while a fat USSR may prove to be a peaceful USSR, so powerful a nation under the control of a single Leninist Party could pose a greater threat to its neighbors and to the US than at any time in the past.

Few Americans would quarrel with that assessment. There are some, however, who harbor the view that the collapse of the Soviet economy would be in the interest of the US. Presumably that extreme event would set off a chain of political effects that would either render the Soviet government incapable of posing any threat to the US, or would usher in a new government whose objectives were more consistent with ours. No one is smart enough, however, to foresee the consequences of so momentous an event, and only a confirmed Polyanna would expect them to be so benign for the US. A catastrophic failure of Gorbachev's reform would more likely strengthen the chauvinistic, nationalistic, militaristic and xenophobic forces that lurk in Soviet society. We might then confront a paranoid neo-Stalinist government, imposing a tough law and order by means of the tight police controls of the past, aggressive in its actions to avoid the appearance of weakness, and drawing popular support from the deep reservoir of traditional Russian patriotism on the basis of the threat from abroad.

The US would feel less secure in that world than we do today. The government of Mikhail Gorbachev would then look in retrospect like the model antagonist: tough and competent but accomodating and able to deliver. Negotiating with the present Soviet government is full of frustrations but it is a responsible government with whom we may succeed in finding ways of advancing our mutual security, though we will not attain perfect security in our lifetime.

The Short Run. The immediate issue for the US is the position we should adopt regarding the new Soviet initiatives in foreign economic policy. This is not the place to discuss the complex issues of managing economic relations between market economies and non-market economies. I offer only a general guide to what I think our position ought to be, based on the view that the success of the economic reform is in the US interest: the US government should take a neutral stance with respect to all normal commercial dealings between the USSR and American business firms and citizens.

By the term "normal" I intend to exclude such matters as the export of technology that has military value, and the commitment of the US to the promotion of human rights. We must continue to maintain US and COCOM restrictions on defense related exports to the USSR, and to the extent that it is US policy to deny certain benefits to countries that violate human rights, we should continue to apply that policy to the USSR no less than to others. But in all matters that can be regarded as normal commerce, we should treat the USSR like all other countries.

A neutral stance means, on the one hand, that we should not discourage American business from expanding normal trade with the USSR or from entering into joint venture arrangements there. Such business should be regarded as contributing to the US interest in the same way as American commerce with Yugoslavia or France or India or Japan is in the US interest. On the other hand, it also means that we should not offer any privileges in the conduct of that commerce that are not available to other friendly countries, particularly newly industrializing countries. We should not be so euphoric about our new friendly engagement with the Soviet government as to overlook our prior interest in the welfare of countries more committed to the political and economic principles we share with them.

Finally, we should be prepared to respond to certain events that are likely to occur during the next few years while the economic reform is still in the process of working itself out. In the redesign of so complex a social system as a whole economy it is inevitable that the parts will not be perfectly articulated on the first try. The more extensive the changes in economic arrangements that Gorbachev succeeds in introducing, the greater the likelihood of miscalculations and unintended outcomes. Shortages of some commodities may develop until improved methods of coordinating demand and supply are worked out. Production will therefore decline for a time in other sectors that depend on those commodities. If some enterprises do indeed engage in direct competition with others, as they will be encouraged to do under the new regulations, the others will experience a shock from which the old system had sheltered them: they will lose some of their traditional customers and will have difficulty selling their output for a time.

These possibilities are very much on the minds of people, and Gorbachev acknowledged the concern forthrightly at the June Plenum. "I must now address a question that is troubling many people. The fear has been expressed that...there may be temporary slowdowns in the growth rate in some branches of the economy, in some regions and even in the economy as a whole." His response is not to deny that such slowdowns will occur, but that the alternative -- continued growth of low-quality, low-value output -- is worse. The government clearly anticipates a slowdown and must be thinking about how to deal with it.

A slowdown in the growth rate, in a period of some confusion in economic transactions, could produce considerable domestic turmoil. Since the new system is intended to enforce a closer link between workers' wages and enterprise profit, some workers will experience a drop in their income, for reasons unrelated to their own effort and diligence, as they will see it. Instances of factory closings and unemployment are likely to occur. Queues may grow longer for some consumer goods from time to time. Ethnic tensions may rise because some nationalities are likely to benefit from the reform while others may be worse off in the short run. Domestic unrest may provoke demonstrations of protest.

Gorbachev's administration has been actively and successfully engaged in mending international fences, in the hope that the foreign scene will be tranquil during the short run period of reform. There is no guarantee, however, that events abroad will not erupt unexpectedly, perhaps triggered off by what may appear to be a Soviet government weakened by domestic turbulence and economic difficulties. It may come from Eastern Europe, or Afghanistan, or the Middle East or elsewhere. A sharp escalation of international tensions, coming at a time of domestic turmoil and economic dislocation, could severely strain the government's ability to maintain control. It may resort to means of maintaining its authority, at home or in neighboring countries, that would provoke outrage in the US. The appearance of instability and weakness may appear to some to offer an opportunity for advancing US interests at the expense of those of the Soviet government.

It is not my intention to prophesy doom. I expect that the Soviet leadership will be fully capable of governing at home and defending its interests abroad. My purpose in calling attention to the possibility of turmoil is to alert your Committee to the prospect that Gorbachev's reform may precipitate events that would strain US-Soviet relations in the next few years.

In responding to such events, the interest of the US would be best served, in my opinion, by steering a middle course. While we have an interest in the success of the reform, we have a more enduring commitment to the promotion of civil rights and to the self-determination of nations. If those values are conspicuously violated by an embattled Soviet government, we should respond in much the same way as we would if there were no Gorbachev and no economic reform. Unfortunately there are few effective instruments of US policy that do not impose any costs at all on some of our own farmers, industrialists and workers. To abjure the use of any such instruments, however, is to signal the Soviet government that there will be no costs to them in their choice of means of maintaining their authority.

On the other hand we should reject the counsel to take advantage of the turmoil in the USSR to promote our interests. We should above all reject the counsel to help that turmoil along for the purpose of destabilizing the Soviet government, in the illusion that the next government will be our grateful friend.

There is no glamour in a policy of the middle course, but it is the wisest we can pursue in the next few years as Gorbachev's reform unfolds.

Senator PROXMIRE. Thank you very much, Mr. Berliner.

Mr. Hewett, please proceed.

STATEMENT OF ED A. HEWETT, SENIOR FELLOW, BROOKINGS INSTITUTION

Mr. HEWETT. Thank you, Mr. Chairman.

My name is Ed Hewett. I am a senior fellow at the Brookings Institution. I speak here only for myself and not for the institution. I will supplement my statement rather than summarize it, speaking very briefly about Gorbachev's goals for his reform and how he is going about it, then discussing the possible outcomes of his efforts and what implications that will hold for us, particularly in the United States.

GORBACHEV'S GOALS

In thinking about what he is trying to do, I find it useful, although somewhat of an oversimplification, to think of two goals that he is pursuing. One of them is to accelerate the growth of the economy, to turn around what has been declining growth rates over the past several decades. At the same time, he seeks to bring about a qualitative transformation in this economy both of the quality of goods and services produced and the efficiency with which they are produced.

During 1985–86 Gorbachev seemed to regard the growth goal as the most important. But in the last year or so he has come more and more to talk about the qualitative transformation. That is what he regards as most important both because that is the only way the Soviet Union can strengthen its position in the world economy—and probably the only way he can effectively deal with problems that they feel are brewing for them in responding to the U.S. threat—and also probably the best way to deal with increasing dissatisfaction domestically with the performance of that economy.

The strategy he has chosen to pursue has many elements, some of them quite traditional, having to do with policy changes and the increased use of discipline. And they are having their effect. The Soviet economy has performed under Gorbachev better than it performed in the previous decade, at least measured by growth rates.

PRINCIPLES OF REFORM

But his long-term strategy is one of economic reform, and there are three basic principles on which that reform rests. The first principle is that the Government will get out of the business of micromanagement of that economy. As it currently stands, the Soviet Government, through its planning agencies, manages virtually all the important transactions in that system.

That has come to a halt, according to Gorbachev's reforms, and the Government will plan less but plan it better. That is, they will begin to focus on strategic issues and try to disengage themselves from the details that underlie the strategic issues.

The second principle is that enterprises will be operating with much more autonomy than they have in the past, with the right to make many more decisions than they have been able to make in the past. But at the same time they will have much more responsibility for the decisions they make.

It is now possible for an enterprise to be declared bankrupt, resulting in worker lay offs. That situation, which did not exist even a year ago, is symbolic of a new approach to the economy in which Gorbachev is trying to denationalize responsibility for the success or failure of the system, to individualize once again the responsibility for whether the system does well or poorly, so that individual workers will now feel that their performance will have an effect upon their own income and their own livelihood.

The third principle of the reform is that the price and financial system will take on much more of a burden than in the past, to actually run the system. This reform will require a price system that is actually flexible, and that responds to supply and demand. Without that, this reform is dead. Gorbachev seems to realize that. In his speech in June at the plenum, in which he laid out the principles of the reform more clearly than ever before, he finally said that price reform was for him the most important part of the economic reform.

OUTLOOK FOR REFORM

In thinking about what consequences this reform might have in the Soviet Union, I find it useful to consider four scenarios. First, let me talk about the two least likely scenarios: total success or total failure.

Total success for Gorbachev would be a situation where growth rates accelerate—that is, he has the growth recovery that he is looking for—and at the same time the qualitative transformation that he is seeking actually occurs. He sees it in a dramatic and sustained improvement in the quality of goods produced. He sees it in a dramatic and sustained growth in the efficiency with which they are produced.

In some of his speeches, Gorbachev has indicated that by the end of the century he would like the Soviet Union to be up to the standards of developed Western countries; that is, he would like them to be at the level of Japan, West Germany, France. I suspect that in the privacy of his office he knows that is not possible. But he would certainly like to see by the end of the century a Soviet Union which is moving in the right direction, in which the quality of goods and services is dramatically improving, and in which growth rates are higher than they have been in the 1970's.

That is the completely successful scenario. I regard that as a very unlikely outcome, in part because it depends on how long it takes to make some of the changes that he is trying to introduce, but also because of some of the mistakes I think he has already made.

The other unlikely scenario for me is a complete failure: economic stagnation and no sustained improvement in the quality of goods and services. I think Gorbachev has already done things that will allow him to avoid that even if his economic reforms do not go much further. The more likely scenarios are the two middle scenarios. I call them the high-growth scenario and the high-quality scenario.

The high-growth scenario is one in which Gorbachev gets the recovery in growth rates he is looking for but the acceleration comes in the production of more of the same sorts of goods and services produced in the past. So, essentially, the economy continues to produce low-quality consumer goods, low-quality manufactured goods, and shoddy apartments. But the growth rate is up to about 5 percent per annum rather than the 2 to 3 percent per annum in the 1970's. Gorbachev might be able to accomplish that by putting pressure on the system, continuing the emphasis on discipline, and introducing policy changes which bring about higher growth.

This is essentially an antireform scenario. That is, for some reason Gorbachev retreats from those parts of the reform that Professor Berliner was talking about which put pressure on the technology in the system and put the pressure on product quality. Nevertheless, it may appear to some to be a successful policy: the growth statistics are good; conservatives are declaring that the "reform" has succeeded.

The other scenario that could transpire, I think, is the high-quality scenario. In the high-quality scenario growth rates are low, possibly 2 to 3 percent per annum in the 1990's. But there is a sustained improvement over time in the quality of goods and services produced.

The best way to think about how this might occur, is to think of what I call a "militarization" of the civilian economy. The military part of the Soviet system now produces high-quality goods and services, but at a high cost. It is not an efficient sector; it is a high-quality sector.

It is conceivable to me that what could happen in the civilian economy as civilian industries respond to the pressure for higher quality, but—because they are operating behind high protective barriers—production costs remain high. The result is an economy in which the quality of goods and services produced is improving but living standards are not improving very quickly, because growth rates are not rising very rapidly.

Now, it is interesting to ask first of all from Gorbachev's point of view, if he is forced to choose between these two scenarios, which he would prefer. The conservatives are going to be pushing him to accept the high-growth scenario because it is the easiest.

But, from what we know of Gorbachev, it is likely he will work against those pressures, and choose the high-quality scenario. It is a moderately successful economic reform in the same sense that Professor Berliner talked about.

IMPLICATIONS FOR THE UNITED STATES

I turn now to our interest in these outcomes. The total success and high-quality scenarios I will call successful reform, either totally or moderately. The high growth or failure I would call the unsuccessful reform.

I think the United States interest probably lies, on balance, in a successful reform. A successful reform would create incentives for other changes in the system—in politics, in foreign policy, and in arms control—that would be in our interest. There is no certainty in this. The links between what happens in the economy and what happens in these areas are many, and they are difficult to predict. But I think that is a good bet.

The second point I would make is that there is not very much we can do to influence the outcome. This is primarily a domestically determined outcome, and the levers that some people in this country seem to think we have are mostly attached to nothing.

There are two areas where we might have some influence over the outcome. One concerns issues such as arms control where I believe, for example, that this reform has associated with it an incentive to come to a set of agreements with the United States that would give the Soviet Union a breathing space. Soviet leaders talk about that.

But in issues such as this we should approach them without thinking at all about the possible consequences for economic reform. We should approach arms control because it is good to approach arms control. The potential links between arms control and economic reform are so tenuous, involving so many chains, that it would be folly for us to think about them.

On the other hand, we face some specific issues coming from the economic reform in which no other aspects are important except possibly United States-Soviet relations in the economic area.

GATT AND IMF

I am thinking, for example, of the Soviet interest in joining GATT or the potential interest in joining the IMF. Here I think it is too early to say what our position should be except to say that it would be, from my point of view, very sensible for us to talk to the Soviets about what they have in mind to begin to get a feeling of what they would be willing to do as a quid pro quo for joining these organizations, because I can conceive of ways in which it would be in our interest to bring the Soviet Union into these organizations and other ways it might not.

Thank you very much.

[The prepared statement of Mr. Hewett follows:]

PREPARED STATEMENT OF ED A. HEWETT[1]

THE JUNE 1987 PLENUM AND ECONOMIC REFORM IN THE USSR

The June 1987 party plenum is an important turning point in Mikhail Gorbachev's efforts to reform the Soviet economy. The results of the plenum certainly do not guarantee that a comprehensive, radical, economic reform will be implemented, and that it will stick. But a radical reform would have been impossible without this plenum. At this plenum Mikhail Gorbachev has finally sought and received approval for the outline of an economic reform which, in its scope and its general tenor, matches his reform rhetoric of the last two years.

The "Osnovnye polozhenie"(Basic Theses) which is the be the guiding document for the reform,[2] and Gorbachev's speech, [3] should be read together. The speech is the best ever by a Soviet leader on the Soviet economy. The sense of urgency is palpable. The critique of the operation of the system is on target, and

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1/ Senior Fellow, The Brookings Institution, Washington, D.C. The material in this article is based, in part, on interviews in Moscow before and immediately after the June 1987 CC party plenum.

2/ "Osnovnye polozheniia korennoi perestroiki upravleniia ekonomikoi," (Basic Theses of the Radical Restructuring of the Management of the Economy) Pravda, June 27, 1987, 2-3.

3/ "O zadachakh partii po korennoi perestroike upravleniia ekonomikoi. Doklad General'nogo sekretariia TsK KPSS M.S. Gorbachev na Plenume TsK KPSS 25 Iuniia 1987 goda," (On the Tasks of the Party in the Radical Restructuring of the Management of the Economy. Report of the General Secretary of the Central Committee of the CPSU, M.S. Gorbachev, at the Plenum of the CC of the CPSU on June 25, 1987) Pravda, June 26, 1987, 1-5.

contains some real gems, even by western standards. And the running dialogue with the skeptics, as well as those who are flat-out opposed, is fascinating.

But in addition to all of those reasons to read the speech along with the "Osnovnye polozhenie," it is necessary because agriculture is only discussed in the speech. The "Osnovnye polozhenie" are limited primarily to the non-agricultural sectors of the economy, mentioning agriculture only in passing, for example, in the discussion of price reform. One can speculate why Gorbachev persists in treating agriculture separately from reform, as he has from the beginning. My own view, based partly on this speech, is that he believes that portion of the perestroika is well under way with the formation of Gosagroprom(State Agro-Industrial Committee), and the policies it is pursuing.

The Basic Approach

The basic approach of this reform is clear, and in its gross logic, makes sense. The enterprise (or ob"edinenie--hereafter, simply enterprise) is to gain significantly increased independence, but simultaneously it will face the possibility of failure. Enterprises in the new system must earn their own way, covering wages and small investments out of current proceeds, and covering larger investments with bank loans, which must be repaid. Large investments, financed out of the central budget, are to to be the exception, and probably limited primarily to the construction of new enterprises and plants. For enterprises which cannot pay their bills, there are insolvency procedures, and ultimately the possibility of bankruptcy. Workers displaced in the process will receive two months notice before losing their jobs, three months of severance pay afterwards, and state assistance in retraining and finding another job.

The enterprise will no longer receive an obligatory annual plan. Instead, it will receive "control figures" at the beginning of each five-year plan, which will cover very few variables: some measure of productive activity, the level of profits and foreign exchange receipts, major indicators of scientific-technical progress, and a few indicators covering the welfare side of the enterprise's activity (presumably housing, child-care facilities, etc.). These "control figures" are not obligatory; they are only for the purpose of "orienting" the enterprise when it constructs its own plan. In addition to these figures, the enterprise will need to take into account: 1.) a set of norms in force for the entire five-year plan linking the formation of enterprise funds (wage, bonus, etc) to final results, and also tax rates, interest rates, and prices; 2.)

state orders (goszakazy) for some of its output, which will have a special incentive price associated with them, and which may be granted competitively; and 3.) Limits on the use of those few centrally distributed materials, capital expenditures, and construction.

In general the enterprise will buy inputs and sell outputs in a wholesale trade network at prices agreed upon between buyer and seller(dogovornye tseny), but set according to rules established and enforced by Goskomtsen(State Price Committee). Goszakazy issued by Gosplan will, however, come with guarantees on inputs. Only prices for nationally-important products, primarily raw materials and fuels, will be set centrally.

These changes in enterprise rights, if they are to stick, imply a radical change in the way the central bureaucracy operates, and the "Osnovnye polozhenie" outline precisely such a change. Ministerial staffs are to be dramatically reduced by eliminating all departments now involved in operational decisions (primarily, but not only, the vsesoiuznye promyshlennye ob"edineniia), and ministries may be merged, both moves designed to eliminate the operational side of ministries' operation in this system. Gosplan is also losing its operational side, and is to focus on the major issues of macrobalance, structural change, and the general direction of science and technology. Gossnab(State Committee for Material-Technical Supply) is to primarily concern itself with the smooth functioning of wholesale trade; Goskomtsen is to focus on enforcing price-setting rules. The banking system will take on increasingly important responsibilities as the locus of decision making on the allocation of capital.

All of these central organizations will continue to have heavy responsibilities concerning the smooth operation of the economy. However the obligations will focus on the use of economic instruments to ensure balance, keep up the pressure for efficiency increases, and encourage innovations.

The reform has major implications for most individuals in Soviet society, both in their role as workers, and also as consumers. As workers they will participate more than heretofore in the management of their workplace through samoupravlenie. At the same time they will have a far more immediate and direct interest than heretofore in the operation of their enterprise since their wages, and their very jobs, will depend on it. Within the workplace, those who are most productive are to receive the highest wages; those who shirk will see the effect in their paychecks.

As consumers the population will surely see increases in the prices of some consumer goods, particularly food, softened somewhat by wage supplements. There is also the promise of an expansion in the supply of food out of a revived agricultural economy (relying heavily on the family contracting system, on new material incentives encouraging farms to increase output, and an investment policy favoring storage and processing facilities. The supply of consumer goods and services is to expand rapidly, in part through expansion of individual and cooperative economic activity, which--by Gorbachev's own account--is not yet going very well.

These reforms are to be implemented in time for the Thirteenth Five-Year Plan(FYPXIII) i.e. 1991. The enterprise law is already on the books, and scheduled for introduction in all enterprises by the end of 1988. Major decrees on the specifics of the other aspects of the reform should be issued this Fall. Some of what will be in those decrees is already obvious from the Plenum. The price reform--which Gorbachev rightly regards as the most important element of his perestroika-- will come in two stages. A revision of prices (raising raw material and fuel prices relative to machinery and equipment) will come within a year, in order to provide new prices in support of preparations for FYPXIII, and for calculating the multitude of norms for 1991-95. A change in the pricing system itself (which means primarily a shift to heavy reliance on contract prices) will be introduced by 1991. Simultaneous with that there will be a myriad of changes in the regulations governing the operations of the entire central apparat, and therefore in its relations with the enterprises.

The Implications of the June Plenum for Economic Reform

The "Osnovnye polozhenie", and Gorbachev's speech, outline the plan of battle for an economic reform, but not the reform itself. There remain a number of important economic and political issues to be resolved if in fact this battle is to be won. I will outline only the most important issues here.

Economic Issues

It was clear in my discussions with Soviet economists involved in drafting the "Osnovnye polozhenie" that the document, with all of its many ambiguities, is the best that could be negotiated in the course of debates over the reform. Many actual reforms would fit within this document, and only some of those would ultimately be judged as "radical". And right now there is no consensus in the government, or even among Gorbachev's economic advisors, on precisely which of the many possible versions of reform will be implemented. What actually happens will be determined if, and when, there is a consensus on the details of actual implementation, a process that will take years. There are several important areas to watch in order to gauge how the implementation process is going, and therefore how radical the reform will be.

One of the most important battle grounds will be over the "control figures." Many of the academics were against this provision in the reform because it is such an obvious avenue for central authorities--particularly the ministries--to continue their micro-management of enterprise operations. The debate over what those figures mean should be heated, but in the end the provisions will surely preserve the non-obligatory nature of those figures. It will be in the implementation of the new provisions that ministries will try to reassert their controls (as they do now in "raschetnye" targets which are actually obligatory), and we shall have to watch that carefully.

The _goszakazy_ are another obvious danger area. There is no consensus now among Soviet economists on what role these will play in the system. If _goszakazy_ are to be only for final output (tanks, typewriters, trucks, etc) of direct use to the state, and if the rest is to be sorted out through wholesale trade among enterprises, then that would be be a truly radical departure from the current system. But if, on the other hand, _goszakazy_ also cover intermediate products (say crude oil, then oil products, then petro-chemicals, etc.), that would amount to a renaming of the current material-technical supply system. During the transition _goszakazy_ will inevitably begin by covering most of output, but the rate at which their share declines, and the extent to which they focus only on final output, will become an important indicators of how rapidly this system is decentralizing.

The test for the sincerity of Gorbachev's stated desire to divest central economic authorities of their operational functions will be in how realistic his expectations are regarding the ability of the center to control this more decentralized system. In the new system ministries, for example, are held responsible for seeing to the satisfaction of social demands for products under their purview, for productivity increases, and for innovation. But, at the same time, they are enjoined to use economic instruments to fulfill these responsibilities, eschewing direct intervention in enterprise activities. Even with the best efforts of ministries, this will only work sporadically, if at all, at first. And even in the long run, indirect instruments will not allow the appearance of direct control characteristic of the old system. If Gorbachev values most highly the use of indirect, "economic", instruments to control the system, and if he is willing to sacrifice some of the appearance of direct control through the ministries, then the new system has a chance. But if he persists in believing that in the new system ministers can actually be held responsible for shortages, inefficiencies, and low quality output of individual enterprises--even though the ministries have no direct control over the operations of those enterprises--then this new system is in trouble. So far the signs in this regard are not very propitious.[4]

Political Issues

Aside from the many unresolved economic issues surrounding the implementation of these reforms--and I have touched on only a few of the most important issues here--there are several important political issues. There is considerable resistance to this reform, and it will grow as the debate turns to the all-important details. Much of the opposition within the bureaucracy is a combination of perceived self-interest, and genuine uncertainty, about whether the new system will work even as well as the old one.

Gorbachev has a running dialogue with the doubters in his speech as he poses their questions for them, and then answers them. Many of the questions are simply those any sane person would raise: will there be a recession in the transition? Will

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4/ Gorbachev begins his Plenum speech with criticisms by name of numerous ministers for specific shortages, and for a general failure to force improvements in the innovative behavior of their enterprises. The quality of enterprise output, and the efficiency with which it is produced, are both outcomes of operational decisions. If the ministries are to be held responsible for the quality and efficiency and operation of "their" enterprises, then inevitably they will be drawn into interfering in the operations of those entepprises.

we lose control of the system by switching from centralized materials allocation to wholesale trade? Will the imbalances grow? These are legitimate issues, and the economists are not going to have very good answers. Economists are best at telling you that you will be better off at "B" than you now are at "A"; but they are far less informative on how to get from "A" to "B", and the chances that you will survive the trip. Gorbachev's answers to these questions are generally the right ones, but still this aspect of the resistance is legitimate, and will continue to be bothersome.

The more general political issues relate to how to first define the essence of socialism, and then preserve it in the new system. Here the debate has taken a fascinating turn as Soviet economists openly argue over the role of unemployment, and more generally economic failure and success, in a socialist system. This is the essence of the reform problem for Gorbachev: how to shift to a different part of the spectrum in the trade-off between economic efficiency and equality, and to sell that politically. There is no easy answer to that, but what is encouraging in the USSR is that the debate is at least focusing on this truly important issue. How that is resolved conceptually, and how it is handled politically, will determine the fate of this reform.

The Future: A Few Guideposts from the Past

In the past reforms in the Soviet Union and Eastern Europe have always looked best when they were first announced. The subsequent haggling over details, and the bureaucratic guerilla warfare, have at least weakened, and usually gutted each reform. Aside from the political support behind a reform, the clarity and consistency of its initial measures significantly influence its longevity and impact on the system. With Gorbachev's reform the political will is there. These are the General Secretary's reforms, which gives them a far greater chance of success than the Kosygin reforms ever had.

The clarity and consistency of the initial measures remains to be seen in the decrees which will come out this year. The June Plenum is a very good start, but the debates of the next few years will be the determining factor. Everything is in the details, and we shall have to watch those details very carefully.

Then, finally, there is the implementation itself, which is where many reforms die a quiet death. It is probably way too ambitious to have this system up and running within 3 years; too much remains to be decided on a conceptual level, after which the very tricky issues of transition must be managed. Even with the best of efforts this reform is unlikely to be fully implemented until the mid 1990s, and that is optimistic.

But if Gorbachev can continue to build his political support, and if he maintains his fervor for reform, then by the end of this century--a mere 13 years from now--the Soviet economy could look much different than it does now. It would still, even in the best case, be a tremendously inefficient system producing many products which could not compete on world markets--that is simply the nature of the lags involved in changing human and physical capital. But it could be well on the way to a more efficient, and quite formidable, economic system.

Senator **Proxmire**. Thank you, Mr. Hewett.

Ms. Schroeder, please proceed.

STATEMENT OF GERTRUDE E. SCHROEDER, PROFESSOR OF ECONOMICS, UNIVERSITY OF VIRGINIA

Ms. **Schroeder**. I have chosen to limit both my prepared statement and oral testimony to areas where I have the greatest competence. That concerns a description and an evaluation of what Gorbachev is up to and what his reform package consists of, what it does and does not do.

GORBACHEV'S INHERITANCE

First, why is Gorbachev undertaking this rather sweeping—at least on paper—change in his economic system? He inherited, by his own admission, an economy in a mess. Productivity had been declining absolutely. Improvements in living standards had slowed to a crawl. The consumer sector was obviously in a state of great malaise.

Worst of all—and I think this is really the primary motivation—he came to realize that the technological gap with the West, however you want to measure this, was enormous and probably widening, and he felt that all this was very unflattering to the Soviet Union's image abroad as a Socialist state, and besides that, potentially threatened its superpower status.

He came in determined to do something about this. I believe that in evaluating what he is up to and how it is going to work, it is not enough simply to consider the reform package per se. He is implementing a set of policies in tandem with his economic reform package. And these policies and the reform package are going to interact to produce certain kinds of outcomes which I will guesstimate when I get that far.

GOALS OF REFORM

So, what is he doing? First of all, he wants acceleration of growth rates and productivity of almost everything across the board. And he has not as yet backed down from this.

Second, he wants to modernize the Soviet industrial sector in a big hurry, and to do this he is implementing a rather radical change in investment policy, increasing the rate of growth of investment, changing the allocation of that investment in a rather dramatic way toward the machinery sectors, requiring enterprises willy-nilly to agree to renovate and reconstruct their enterprises and, in general forcing them to use the capital stock much more intensively by mandating second and third shifts practically everywhere.

Now, those are some of his policies. In addition to that, he wants to change the working habits of managers and workers alike in a radical way. He wants to produce disciplined workers who appear at work on time and sober, who care about their jobs, who want to produce high-quality goods.

Similarly for managers. He wants managers who act, if you think about it, like managers are forced to act in a private enterprise market environment—namely, to be efficient, try to produce at low cost, produce high-quality goods, welcome innovation, retooling and construction—so that output and its quality can be improved.

PERESTROIKA

How is he going to get these new, what shall we call them, not new Communists—maybe new Socialists, new Gorbachev workers and new Gorbachev managers? He wants to, he says, restructure virtually the entire Soviet society. The Russian word is perestroika, a very wide-ranging concept.

It encompasses the idea of glasnost', this openness, which I regard as an extremely important and highly welcome development in the Soviet Union. It encompasses attacks on other social problems that he is undertaking. But in the economic realm above all, restructuring, perestroika, involves restructuring the entire economic mechanism—his "radical," and "revolutionary," to use his words, economic reforms, which, according to his words again, are based on the principle of "more socialism, more democracy."

In the prepared statement that I have presented to the subcommittee I have burdened you with a rather lengthy—at least you may think it is very lengthy—description of this reform package, which we now have.

I believe it is essential to distinguish between Gorbachev's speeches and rhetoric and the legal documents that we now have. We have laws and a packet of decrees, so we know what the package is going to look like. It covers the waterfront. It is comprehensive, to a fare-the-well, I would say. It involves major shakeups of the bureaucracy.

There is a timetable for these reforms. They are all being carried out, concentrated practically in the next 3 years, so that by 1991 the start of the 13th 5-year plan, this whole so-called new economic mechanisms will be in place.

Already the bureaucracy is being shaken up, reduced, reorganized, and reshuffled. The enterprises, beginning next year, will operate under newly expanded freedoms laid out in the New Law on the State Enterprise. I think it would make a lawyer's hair turn white—or pink.

It's a nightmarish document that sets forth these rights and obligations of the enterprise. It is going to be very difficult to figure out precisely what they mean. It will force enterprises, beginning next year—most of them—to operate on what is called self-finance, paying for their own expenditures out of their own incomes.

It involves derationing a good many raw materials. It involves a price reform which is supposed to take place in 1990 or 1991—a revision, I should call it—and the greater use of contract prices.

It involves an overhaul of the entire wage and salary structure throughout the country, but this is not all. There are some reforms in agriculture, decentralization in foreign trade, and finally, an expansion of the scope of private and cooperative economic activity.

OUTLOOK FOR REFORM

What do I make of this package, which I've been poring over for weeks, studying these new documents from a long background of having looked at similar documents?

I would say the following about the present package—I cannot assess possible future packages, we don't have them. But, we do have the present package.

It is, indeed, the most wide-ranging set of changes proposed since Stalin introduced the centrally planned economy. It is a very impressive package, but I view this package, nonetheless, as one having been put together in haste. It's not a well-crafted thing, in the final analysis.

It, in my view, will not work very well because it really doesn't change most of the basic parameters of the system. It leaves a very large role for central planning in the form of state orders and the ubiquitous, so-called normatives which regulate enterprise activity.

That's the first thing. Second, it leaves the ministries and other bureaucracies in place, with very wide-ranging powers accorded to them in these documents.

The enterprises remain subordinate to these ministries. The enterprises' fate, in a very fundamental sense, depends on how they administer these reforms.

Enterprises also remain state-owned. The business firms will be very constrained, among other things, in their so-called freedom to get together and to contract.

Although some derationing is now taking place, it is being done by the bureaucracy that has carried out the rationing of supplies for years. This bureaucracy, I observe, is delighted with this new responsibility, and it's already helping the enterprises to organize wholesale trade in a way that is against the spirit of the reforms.

PRICE REFORM

The price reform is more of the same, as we can now visualize it from the documents and the speeches of the Price Committee's chairman. So prices are not going to be market prices; rather they are going to be prices centrally set for 5 years now for a wide range of goods. Contract prices will have to depend to a great degree on these centrally set prices and methodological instructions.

CONTRADICTIONS AND INCONSISTENCIES

I think that the reform package is riddled with contradictions and inconsistencies—I've found 10 or 11. One very important one is that they fail to address the creation of capital markets and to provide a better mechanism for allocation of investment funds.

Senator **Proxmire**. Can you wind up in about a minute?

Ms. **Schroeder**. Yes. What difference will all this make?

I agree with Joe Berliner that, in the first instance, this is going to be a very difficult set of reforms to carry out. Unless Gorbachev changes this package radically, I do not think that the economy will benefit very much. And I'm not sanguine about the outcome in the next few years, because the reforms will create serious problems.

What the leaders will do then is a matter of speculation, they might introduce a new NEP. They might introduce a full-scale Hungarian reform, or they might just make adjustments that will leave things much the same.

I'm not a forecaster.

[The prepared statement of Ms. Schroeder follows:]

PREPARED STATEMENT OF GERTRUDE E. SCHROEDER

By his own admission, General Secretary Gorbachev inherited an economy in a mess. Growth rates had fallen sharply since 1970 in the economy as a whole and in the long-favored industrial sector. The overall productivity of resources used in the economy had declined markedly, and the technological level of the capital stock was backward by comparison with the capitalist West. Soviet manufactures were largely unsaleable there, and their quality was the subject of perennial complaints from domestic purchasers. The rate of improvement in living standards had slowed to a crawl, and random shortages, black markets, and queues were pervasive. A kind of malaise seemed to beset the populace, manifested in reduced work effort, widespread alcoholism, rampant corruption, and a burgeoning underground economy. Such a state of affairs, highly unflattering to Soviet socialism's image abroad, also threatened the USSR's status as a superpower and the legitimacy of its political system. Gorbachev has vowed to turn the situation around, mapped out a strategy for doing so, and proceeded to implement it with vigor.

The Goals and Strategy

Gorbachev's goals and strategy for achieving them are vividly expressed in three Russian words that have become rallying cries and "buzz words"--uskorenie (acceleration), intensifikatsiia (intensification or an upsurge in efficiency), and perestroika (restructuring). Above all, acceleration applies to growth rates for the economy and all major sectors. The goals are set out in the Twelfth Five-Year Plan adopted in June 1986 and in the specific plans for 1986 and 1987. Growth of GNP is slated to be about 4 percent annually during 1986-90, double that achieved during 1976-85, and then to rise to somewhat over 5 percent during the 1990s, thus returning to growth rates of the 1960s. Similarly, industrial growth during 1986-90 is targeted to be more than double that in the preceding decade and even higher during the 1990s. The gain in agricultural output in 1986-90 is to be triple that of the preceding 15 years. The growth of investment is to accelerate and to be faster than that of consumption. As a consequence, only a modest gain in living standards is planned for this five-year plan, but they are to improve at a much faster clip in the 1990s, so as to realize an overall gain of 60 to 80 percent in real income per capita, the Soviet official measure of changes in living standards.

A critical part of Gorbachev's turnaround strategy is his investment program designed to modernize the industrial sector in a hurry. Not only is the growth of investment to be accelerated, but priorities are to be altered in major ways. The bulk of investment is to go toward reconstructing and reequipping existing plants, rather than building new ones. In support of the drive to modernize the nation's antiquated capital stock, the plans call for nearly doubling retirement rates and replacing over one-third of the total capital stock by 1990. This gigantic task is to be made possible by an increase of 80 percent in the amount of investment directed to the civilian machinery industries, compared with a gain of perhaps 20 percent in the preceding five years. With this investment, the machinery industries are to double the rate of growth of output and radically upgrade its quality and technological level. By 1990, 90 percent of all machinery is supposed to meet "world standards," compared with about 20 percent now.

The planned accelerated growth across the board is supposed to be obtained by an upsurge in the efficiency with which labor and capital are used. Indeed, without such a breakthrough, sustained accelerated growth is impossible. Demographic factors limit the growth of the labor force to about 0.5 percent per year, and the capital stock necessarily will grow more slowly than previously because of past and present investment policies and planned accelerated retirement of old capital. To achieve the economic growth rate targeted for 1986-90, the growth of labor productivity will have to double, and the rate of improvement in the productivity of all resources will have to return to levels not experienced since the 1950s. Along with strenuous targets for economizing on use of energy and raw materials, the strategy demands large gains across the board in the technical quality of all manufactures and a radical upgrading of the modernity of their design.

To get the accelerated economic growth that he deems essential and the boost in efficiency that is required, Gorbachev has launched a vigorous and many-faceted campaign to "restructure" Soviet society. Gorbachev wants to fundamentally alter the thinking and behavior of workers and managers, so as to transform them into disciplined employees who appear at work on time and sober, put in a full day's work, take personal responsibility for the quantity and quality of the product, and are innovative in seeking ways to produce more and better products with fewer resources. To bring this about, Gorbachev has called for "radical economic reforms," intended to alter the basic parameters of the so-called "economic mechanism," i.e., economic organization and incentives, so as to orient producing enterprises and their employees in the directions desired. In his two and a half years of tenure, he has acted vigorously to further the desired restructuring, through many speeches filled with exhortations and a series of actions to put in place his program for economic reform. Gorbachev has characterized this program as "radical", "revolutionary," and rooted in the principle of "more socialism, more democracy."

On June 30, 1987, the Supreme Soviet approved by decree a package of measures designed to alter the ways by which the Soviet economy is managed. These measures are set forth in a document approved a few days earlier at a plenum of the Central Committee of the CPSU: the document is entitled "Basic Provisions for Fundamentally Reorganizing Economic Management" and is supplemented by 11 documents not yet available. The Supreme Soviet also adopted a new Law on the State Enterprise that forms a key part of the reform package. Also included are the decrees adopted in 1986 mandating an overhaul of the entire wage and salary system, reorganizing the conduct of foreign trade, expanding the responsibilities of regional authorities, and sanctioning expansion of the scope of economic activity by private individuals and producer cooperatives, as well as actions taken during 1985 and 1986 to reform agriculture and to establish new bureaucracies and reorganize old ones. As a whole, this program provides the present official blueprint and time schedules for putting into place a "new economic mechanism" that is supposed to be almost fully operational by the start of the 13th Five-Year Plan in 1991.

Description of the Reform Package

1. Role of Central Planning

The Basic Provisions stress that the economy is to continue to be centrally planned and managed as "a unified national economic complex" directed toward carrying out the Party's economic policies. These policies are to be embodied in a 15-year plan that sets goals and priorities and outlines a program for implementing them. This plan, which is to contain specific targets for the 15-year period, is to be the basis for detailed formulation of the plan for the initial 5-year period, with a breakdown by years. As now, this plan will be worked out by the State Planning Committee (Gosplan) and sent down to union republic Councils of Ministers and to ministries. These bodies, in term, send "initial planning data" to firms, on the basis of which they work out and ratify their own 5-year and annual plans.

The firms receive: (1) "non-binding control figures" that specify value of output, total profits, foreign currency receipts, and "major indicators of scientific and technical progress and social development", the list to be fixed by the USSR Council of Ministers (2) a mandatory bill of state orders for output that includes commissionings of facilities financed by state centralized investment and products essential for fulfilling priority state tasks for "social development, scientific-technical progress, defense, and deliveries of farm products" (3) limits, which include rationed goods and centralized investment allocations (4) long-term economic normatives according to a list approved by the Council of Ministers, regulating such matters as growth of total wages and the allocation of profits among various kinds of taxes and funds.

2. Position of the Firm

The Law on the State Enterprise fixes the intended status of the firm under the reforms in a fair amount of detail. The law takes effect on January 1, 1988, and firms are to be put under its full provisions gradually during 1988 and 1989. Firms, which are founded and liquidated by superior bodies, remain under state (all-people) ownership and formally subordinate to government agencies (ministries or regional bodies).

The firm now "independently" works out and approves its 5-year and annual plans, based on control figures, mandatory state orders, limits, economic normatives, and contracts with customers. The Law states, "The enterprise is obligated to strictly observe plan discipline and meet plans and contractual obligations in full." It states further, "Fulfillment of orders and contracts serves as the most important criterion for evaluating the activities of the enterprise and providing material rewards for its employees."

The reform documents require the firm "as a rule" to finance all of its current and capital expenditures from its sales revenues and other internally generated funds--a condition labelled "full economic accountability and self-finance." Furthering Gorbachev's call for "more democracy," the Law provides for setting up elected enterprise Labor Councils and for election of key managerial personnel, down to the level of foremen. Work collectives are supposed to set up Councils and elect leaders during 1987-88. The Law supposedly greatly expands the decision making authority of the firm by providing that it "is entitled to make on its own initiative any decisions provided that they do not run counter to existing legislation." The Law endows the firm with "rights whose observance is guaranteed by the state" and provides means by which the firm may obtain redress if superior organs violate such rights. Finally, the Law explicitly provides for declaring bankrupt and liquidating firms that persistently make losses. Displaced workers are to be given severance pay and helped to find new jobs.

3. Role of Central and Regional Administrative Bodies

Gorbachev's recipe for managerial reform includes implementation of an idea frequently advocated by Brezhnev--setting up super-ministerial bodies to oversee groups of related economic activities. Six such bodies were set up during 1985 and 1986.

The plenum documents make clear the intent to carry out a major shakeup of the central and regional bureaucracies, revising their functions, reorganizing their structures, and cutting their staffs. According to Premier Ryzhkov, all this is to take place during 1987-88. Gosplan, whose staff is to be reorganized to deemphasis sectoral sub-divisions, is supposed to concentrate on long-range strategic planning and development of techniques for managing the economy through "economic methods"--long-term plans and normatives, finance, prices and credit. More specifically, Gosplan is supposed to coordinate the work of all central bodies dealing with the economy, work out 5-year and 15-year plans and transmit them to executants, and determine the composition of state orders. The State Committee for Science and Technology is to be reorganized to carry out its main functions of working out state programs for development of science and technology; specifying and monitoring the relevant state orders and guiding the work of inter-sectoral scientific and technical complexes, whose role is to be expanded.

The number of ministries is to be reduced, and they are to be reorganized to eliminate sectoral sub-branches (glavki) and to cut staffs. In place of the glavki, the new scheme is to have "several thousand" large associations and enterprises directly subordinated to an all-union ministry; this is to be accomplished by the end of 1988 by accelerating the on-going process of amalgamating enterprises into production and science-production associations and creating large new groupings called "state production associations," which integrate entities engaged in all phases of the research-production-marketing chain. While supposedly being relieved of the functions of day to day control over firms, the ministries are still given enormous responsibility. According to the Basic Provisions, the ministry "is responsible to the nation for satisfying demand for the branch's product, preventing disproportions, ensuring that the product meets world technical and quality standards, and working out and implementing branch scientific and technical programs." As now, it is to serve as an intermediate level in the planning process and monitors the performance of subordinate firms, including preventing monopoly behavior.

The Basic Provisions and a decree of July 1986 convey the intent to accord the republic Councils of Ministers and their subordinate bodies, notably the local Soviets, a greater role and responsibility for regional economies, especially those aspects relating to the welfare of local populations. These bodies, too, are supposed to be reorganized to improve administration; thus, "production-economic departments" are to be set up under local Soviets and other regional bodies.

4. The Supply System

The Basic Provisions call for a "decisive transition from centralized allocation of material resources and the attachment of users to producers to wholesale trade in the means of production," to be completed in 4 to 5 years. Only "particularly scarce" goods will continue to be rationed, and they include the raw materials that are required to fulfill mandatory state orders. Wholesale trade, which is to become the main form of supply, is to take the form of "free" purchase and sale under direct contracts between the parties or with wholesale organizations, and with manufacturers' direct outlets. The Law on the State Enterprise indicates that regional units of the State Committee for Material-technical Supply (Gossnab) are to play the major role in supply. A Council of Ministers decree adopted July 17, 1987 instructs Gossnab to bring the share of wholesale trade in total sales to 60 percent by 1990 and to complete the transfer by 1992, when it is supposed to cover 75-80 percent of all goods that pass through that network, according to Gossnab's Chairman.

5. Prices and Wages

The Basic Provisions call for a "radical" reform of prices to be completed by 1990, so that the new prices can be used in developing the 1991-

95 plan. Unlike its predecessors, this reform is to encompass all forms of prices--wholesale, procurement, and retail prices and rates, with changes in the various sets of prices to be inter-connected. Centrally-set prices, the share of which is to be "sharply reduced," are to be determined as part of 5-year plan formation and fixed on the basis of "socially necessary expenses of production and sale, utility, quality, and effective demand." They are to take into account the charges for natural resources, capital, and labor, which enterprises will now be required to pay, and also are to cover the costs of environmental protection. More specifically, prices of fuels and raw materials are to be raised sharply, so as to ensure normal profitability for those branches. Contract prices, limit prices, and those set by enterprises are to become more common and are to be set on the same basic principles as state-set prices. Those principles and procedures are to be laid down and all prices closely monitored by state organs, presumably the State Committee for Prices.

The sensitive issue of revising retail prices to conform to the new pricing formula is addressed by calling for a broad public discussion of the price reforms and by stating that changes in retail prices "not only must not reduce living standards of workers, but also must raise them for some groups and more fully promote social justice." At present, some foods and services are heavily subsidized, now costing the state budget 73 billion rubles. Alcoholic beverages, clothing, many durables, and luxury goods are heavily taxed.

An essential ingredient of the reform package is a major overhaul of the wage and salary structure, to be carried out branch by branch and firm by firm during 1987-1990, whenever they are able to finance the higher wages by cutting the workforce or making other economies. The intent of this sweeping reform of the pay system is to raise the role of job rates in workers' earnings, make bonuses harder to get and more closely dependent on the efficiency and quality of performance of both the worker and the firm, tighten work norms, and contribute to more general reform objectives of enforcing self-finance, eradicating "wage-leveling," and encouraging work effort and acquisition of skills by the workforce.

6. Agricultural Reforms

Besides endorsing the 1982 Food Program, Gorbachev has spelled out his recipe for agricultural reform in two major decrees. The first one, adopted in November 1985, established the State Committee for the Agro-industrial Complex (Gosagroprom), a super-ministry to manage the production, marketing, and processing of farm products. It was formed as a merger of five ministries and a state committee, but agencies in charge of grain procurement and land reclamation remain independent. This reorganization also was intended to strengthen the position of the regional agricultural production associations (RAPOs) that had been set up as part of the 1982 Food Program. The second decree, adopted in March 1986, was directed toward increasing the autonomy of farms and improving incentives. The principal provisions of this complex and ambiguous decree are to permit farms to sell at market prices a larger share of production, to introduce measures to market farm products more flexibly, to extend to farms many of the arrangements now being applied in the industrial sector (such as normative planning and self-finance), and to endorse the widespread use of collective contracts.

The Basic Provisions and the Law on the State Enterprise apply in general to agriculture. Although there are few specific references to that sector in these documents, Gorbachev addressed agricultural matters at some length in his speech to the June plenum. He stated that the measures already effected had created the potential for a breakthrough in farm output. He strongly endorsed the use of collective contracts, especially brigades using intensive technology and family groups. In a later speech, he stated that agriculture was to be the subject of a future plenum.

7. Foreign Trade

Gorbachev's reform package includes an overhaul of the system for conducting foreign trade. The relevant decree: (1) established the State Foreign Economic Commission as a super-ministry overseeing all facets of foreign economic activity; (2) reorganized the Ministry of Foreign Trade to end its monopoly over trade by transferring some of its foreign trade associations to the jurisdiction of ministries and other central bodies; (3) granted the right as of January 1, 1987 to some 20 ministries and other bodies and 70 selected enterprises to engage directly in importing and exporting activity with appropriate units in foreign countries; (4) provided for setting up foreign currency funds in exporting enterprises and associations that can be used independently to finance imports of machinery and equipment; (5) gave firms extensive rights to engage in joint projects with firms in CMEA countries, and (6) sanctioned joint ventures with firms in capitalist countries. Subsequently, regulations were issued detailing procedures for carrying out such joint projects. Finally, the Basic Provisions call for implementing a "stage-by-stage" convertibility of the ruble, starting with the CMEA trading system.

8. Private and Cooperative Economic Activity

The documents from the June plenum strongly endorse reform measures adopted in 1986 that aim to expand the role of producer cooperatives and private individuals in the economy, particularly in the provision of consumer goods and services. A law adopted by the Supreme Soviet in November 1986 spelled out the kinds of permissible endeavors (only a few new kinds) and the groups that are to be encouraged to engage in them (state employees only outside working hours, pensioners, housewives, and the handicapped). The Law took effect on May 1, 1987, along with revisions in the income tax that lowered somewhat the extremely high tax rates on income from private work. In August 1986, the Politburo approved some "basic principles for development of cooperative forms of production" (not yet published), which specify that producer cooperatives are to be organized on a voluntary basis "with the participation of ministries, departments, and local Soviets." Subsequently, the Council of Ministers promulgated Model Charters for experimental cooperatives to be engaged in the collection and processing of waste materials and for producing consumer goods and services. The decree on expanding the rights of local Soviets adopted in June 1986 gives regional and local government bodies the major role in developing and regulating cooperative and private businesses.

Evaluation of the Reforms

1. The Total Package

Taken as a whole, the package of reform measures already in place or set en train by Gorbachev in his first two and a half years of tenure is impressive. Embracing nearly every major aspect and sector of the economy, its scope is much more sweeping than that of the 1965 reform package, which focused on the industrial sector.

But one is hard pressed to visualize the kind of economic system that the framers of this package intend to introduce. Certainly, its overall design is not that required to install a system of market socialism or of worker self-management as those terms are usually understood. It borrows bits and pieces from the various reforms taking place in East European countries. Despite allusions to creating antonomous, competing, self-managed business firms, the reforms do not go nearly far enough to create a market environment, nor do they allow workers to make key decisions that determine the outcomes of the firm's activity. The reforms leave the pillars of socialist state economic administration prominently in place--state ownership, central planning (albeit changed in form and reduced in detail), numerous administriative agencies supervising business firms, rationing of many materials and investment goods, state control over price-setting, and enterprise incentives still oriented toward plans and output targets and biased toward dealing with administrative superiors rather than following the signals from markets. Moreover, the package, as spelled out in formal decrees as well as in the speeches of the leadership, is riddled with inconsistencies and contradictions that will create serious problems in the process of implementation, especially so since Gorbachev is a man in a hurry. This reform, far more than its predecessors, imposes a staggering set of tasks on the central bureaucracies and on the producing units to be accomplished in the next three years. At a meeting on July 17, 1987, the USSR Council of Ministers excoriated one and all for not moving fast enough on all fronts and imposed some specific tasks and deadlines. At the same time, both bureaucracies and enterprises are under continuous pressure to meet the demanding targets set by the plans for 1987 and 1986-90.

Potentially the most disruptive facet of the reforms is the schedule for imposing conditions of full self-finance on the enterprises. In 1987, those rules of the game affected all firms in five industrial ministries and 37 entities in various others; together they represent about 20 percent of total industrial output and 16 percent of employment. According to Premier Ryzhkov, self-financed enterprises will account for 60 percent of industrial output in

1988, when the new conditions will also apply to branches of transportation and a number of other sectors. The new rules already are creating difficulties for many firms, according to press accounts.

2. Key Parts of the Package

a. Central Planning and Management

The policy statements and specific provisions of the reform program make it clear that strong central management of the economy is being retained. They display the tradional conviction that economic development--the composition of output and the direction of investment--as well as the broad content and direction of scientific and technological progress must be managed by the center. The framework of mandatory, "stable" 5-year plans is retained, along with new and old government bodies to guide and monitor their outcomes. New forms of central management--"non-binding" control figures, state orders, and long-term, stable normatives--replace the familiar categories. These instruments, along with prices and interest rates, are now to be the means by which the state controls the behavior of its enterprises. That the center is to slough off a mass of detail is of secondary importance.

b. Position of the Firm

The business firm remains subordinate to government agencies, which are to eschew "petty tutelage," while ensuring that the sector's output goals are met and that the firm behaves "properly." Absence of "petty tutelage", if it eventuates, may reduce the frustration of managers of firms, but ministerial micro-management, which many people are prone to blame for all sorts of malfunctions, has been a minor factor in the past difficulties of the economy in any case. On the contrary, under the new arrangements, the firm is likely to be eager to have ministerial aid, particularly in respect to the functioning of the assorted normatives, which undoubtedly will provide a fertile field for bargaining. While being pushed to "freely" negotiate contracts for much of its output with customers and for the requisite raw materials and capital goods with suppliers in a framework of competition, the firm will find that the tissue (information and infrastructure) needed to support competitive sales and purchases is almost totally lacking. Portions of its product and raw materials will have rigid state-set prices as now, and the prices it may set or negotiate are subject to methodological guidelines and strict state monitoring. The manager's bonus depends on meeting (planned) contracts for output (little different under universal contracting from gross output or sales), as well as on indicators for several other aspects of performance. Finally, the new deal provides the firm with still another participant in decision making and monitoring--the Labor Council--and subjects its key managers to the elective process. Since all of this does not fundamentally alter the real position of the firm in the economic process, its behavior is unlikely to change much either. It is likely to remain risk-averse and center-oriented.

Although the vision--figuring prominently in the reforms--of autonomous, self-financing, socialist business firms threatened with bankruptcy for failure conveys an aura of markets and competition, it is, in fact, an artificial accounting construct, both under present Soviet conditions and under those created by the reforms. Because prices of products and material inputs do not reflect the economic tradeoffs (scarcities), the derivative accounting categories of sales, costs, profits, and returns on capital can be misleading. Managerial decisions based on them may not result in efficient mixes of inputs and outputs, profits do not indicate relative efficiencies of firms, and failure to earn profits and thus go bankrupt does not necessarily mean that the firm was inefficient. The belief that large gains in efficiency will accrue from enforcing self-finance under such conditions is a grand illusion.

c. Supply

Along with its call for "resolute" shift of the bulk of purchases and sales of intermediate and capital goods from central rationing to wholesale trade between competing buyers and sellers, the Basic Provisions accord Gossnab a key role in the process. Faced with the need to nail down through contracts its "independently" planned sales and purchases, firms in the near term can be expected to scramble to keep existing arrangements and tie up new ones. These arrangements, by and large, are likely to form the basis in the 13th Five-Year Plan for the contracts on which the firms are required to base their plans. All this will create much confusion and also make for rigidity, not the flexibility that is needed.

d. Prices

The extent to which prices reflect supply and demand is the key to the success of any market-oriented reform. But the principles on which state-fixed prices and contractual prices are to be set are the same as used now--essentially average cost-based in the case of wholesale and procurement prices. The requirement that they remain stable for 5-years for state-set prices and be embodied in planned contracts in the case of contract prices preserves the rigidities now prevailing. Hence, prices will be little better guides to efficient choice than now. Moreover, widespread use of contract prices will be inflationary, unless hard budget constraints are imposed on both parties, something the reforms do not really do. Clearly, the government intends to monitor such prices closely, requiring it to peer into the detailed books of individual firms. Finally, the declared intent to link the three sets of prices--wholesale, procurement and retail--involves coming to grips with a major political-economic policy dilemma of what to do about the existing huge subsidies on food and some services for consumers and the large subsidies on machinery and fertilizer sold to farms. We shall have to wait to see what political will can be mustered.

The planned overhaul of the wage and bonus system could be highly disruptive. Unlike its predecessor in the early 1960s, which offered a large carrot in the form of a substantial reduction in the workweek (from 46 to 41 hours), the current wage reform offers no carrot to the rank and file workers. Although their base rates will be increased, their work norms will be tightened accordingly, and they will bear the brunt of layoffs, pressure to re-define and combine jobs, and demands to work second and third shifts. Meanwhile, earnings of white collar workers will increase sharply. Will blue collar workers, long nurtured on egalitarian values, regard those developments as fair, even though economically justified to correct the present unduly narrow differentials that blunt incentives?

Since the wage overhaul is being carried out piecemeal and firm by firm, both between sectors and within sectors, the potential for creating inequitable differences in wages and in the provision of amenities is great. This potential arises because of the highly uneven conditions under which Soviet enterprises operate that stem from factors over which they have little or no control. The playing field is unequal and in a fundamental sense also unfair. Meanwhile, workers and managers alike will have to cope with the new rules for workplace democracy. Whether either group will find virtue in the new environment remains to be seen.

Some Tentative Conclusions

The reform programs adopted thus far under Gorbachev are a set of half-measures that retain the pillars of the traditional system. Even if the measures now outlined are fully implemented, as clearly is now intended, they do not go nearly far enough to accomplish Gorbachev's goal of creating a self-regulating, technologically dynamic "economic mechanism," capable of rapidly closing the gap with the West. Those goals will be frustrated by the approach to pricing, a failure to take steps to create capital markets, and the large dose of central administration that is retained. Even when the reforms are fully in place (1991), they will constitute a hybrid system that is neither fish nor fowl and that is likely to require further reforms.

Meanwhile, the reforms, being introduced piecemeal, impose so many changes and range over so much of the economy as to risk serious disruptions in the production process. In fact, disruptions are already occurring in 1987. Some sectors and parts of sectors will be operating under old procedures and others under new procedures, which are being phased in and worked out on the run, so to speak. The key agencies that must issue the necessary documents and monitor the process will be undergoing reorganizations and staff reductions. The risk is heightened by the unremitting pressure (as of now) to increase production, improve product quality, and proceed rapidly with plant modernization. The leadership has recognized that the next few years will be difficult. How it will react if growth rates tumble is a matter of speculation. The pressure for production could be relaxed and/or the reform timetable stretched out. Conceivably, the leadership could introduce a really radical reform, as Lenin did in 1921 with his New Economic Policy (NEP), which quickly introduced large doses of private enterprise and markets in the economy. Alternatively, it could continue to liberalize the present semi-market scheme, taking the reforms in directions now being pursued in Poland and Hungary. Or adjustments could be made that would preserve the essentials of the status quo into the 13th Five-Year Plan period and beyond.

Gorbachev has already shown that when his "reforms" are not eliciting the desired outcomes fast enough, he will resort to the traditional administrative methods. Recent decrees mandating state inspection of output, multiple shifts, and inventory reductions are cases in point.

This somber judgment on Gorbachev's reform package does not mean that it has no redeeming features. It moves in the right direction--toward decentralizing and marketizing the economy. If the yo ahead for private and cooperative gains produces strong momentum, it will improve the lot of consumers to some degree. The somewhat greater leeway given factories and farms to dispose of above-plan output and unneeded inputs will work mainly to that same end. Some paring of government staffs and forced redistribution of labor, which is likely, will facilitate adjustment to slow growth in the labor force. Relatively higher wages for skilled and efficient workers should improve incentives. Some gains in efficiency could result from all of this. But Gorbachev aspires to have a Japanese miracle-type production system in place in the USSR of the 1990s. His reform package as now laid out is not nearly radical enough to bring that about.

The short-run costs of implementing Gorbachev's present reform package are going to be high and the benefits few and slow to come. These costs will show up in disruptions in production, in slowed real gains in the quality of machines and of consumer goods, in a chaotic and unfair structure of wages, and in rising economic insecurity almost everywhere. When these costs mount, so will the pressures for reversion to old and familiar ways. The central bureaucracies will be eager to intervene to alleviate the problems. Enterprise managers will seek relief from the confusion and uncertainties of their new environment. Rank and file workers will not like the erosion of the "social contract" with their rulers (low work effort in return for economic security and political quiescence), when the benefits are hard to see. Local party units will find restructuring extremely painful, especially since they will be blamed for the shortcomings.

Even if Gorbachev manages to prevent backsliding and succeeds in pushing his present programs in more liberal directions (toward the Hungarian model), he is likely to be disappointed in the results, as the Hungarians have been. There, substantial economic reforms over 20 years have yet to produce significant gains in economic efficiency and growth. Decades of a centrally managed socialist economy leave formidable legacies in terms of people's outlook and attitudes and in terms of the state of the economy's physical assets. Much time will be required to overcome such legacies. Ultimately, Gorbachev and other would-be reformers are going to find that they cannot obtain the benefits of a private enterprise market economy, which they seek without creating one, with all its attendant blemishes. Experience, as well as theory, have yet to show that any species of half-way house will do the trick.

GATT AND IMF

Senator **Proxmire**. Thank you very much, Ms. Schroeder.

Professor Berliner, we're going to take 5 minutes in our questioning.

You urge the United States to follow a middle course, as you put it, in dealing with the Soviet Union. Would such a policy mean allowing the Soviets to join international institutions, such as GATT, the World Bank, IMF?

Why would it be for or against our interests to do this?

Mr. **Berliner**. I share Ed Hewett's view that we should enter into discussions with the Soviets on their request for entry into international organizations with the objective of developing methods of fair trading. It's a process we've been engaged in over 40 years now, the process of developing methods for better organizing, international commerce among market and nonmarket economies.

Senator **Proxmire**. Let me just interrupt. You see, the reason why I'm asking that question is because the Defense Department is taking a strong adverse position, as you may know.

David Wigg, in testifying before this committee last week, said the following:

> There is a fear that the Soviet Union's desire for a place at the table stems more from a bent for political troublemaking than for any desire to participate responsibly.

Mr. **Berliner**. That is a risk. On the other hand, you have to balance the risk against the benefit. If you start from my point of departure that it is in the U.S. interest for American business to have an opportunity to engage in normal trade with the Soviets as well as with other countries, and in the normal course of events, if we don't, other countries will, then it is further in our interest to develop ways in which the Soviets can participate in organizations like GATT or the IMF.

There are certain kinds of concessions which centrally planned economies have to make in order to be able to live up to the commitments of nations under GATT. The familiar example is that GATT is based upon the notion that the way in which market economies limit trade among themselves is through tariffs and subsidies. In the Soviet case, however, the case of centrally planned economies, that's not what determines limitations in trade. Central planning governments don't have tariffs. They limit trade in other ways. One of the things we could do in GATT is to try to work out a set of arrangements to try to reduce the capability of the Soviets to discriminate by measures other than tariffs, which won't do it.

So, in summary, I think we should enter into agreements or enter into discussions with them and try to develop general laws for easing nondiscriminatory commerce between market and nonmarket economies.

Senator **Proxmire**. Thank you very much.

OUTLOOK FOR REFORM

Mr. Hewett, are we witnessing a fundamental reform of the Stalinist economic system? Or something less than that?

And what indicators should we watch to see whether fundamental reforms are occurring?

You pointed out, it seems to me—and I think you were the one who did this—that the Soviet Union under the Gorbachev proposal might not get an increase in growth, they might get an increase in quality.

The problem there is that growth is measurable—at least more measurable. Quality is not.

Does quality mean, for example, a higher fidelity for rock music, or a higher proof for vodka? Where do we draw the line?

Mr. **Hewett**. I am not yet sure that we are observing a fundamental reform. But, if there is to be a fundamental reform, some of the steps that have been taken would be indispensable; in particular, this outline of the basic principles approved at the June 1987 plenum is quite important.

Whether or not it will turn out to be a fundamental reform depends on a myriad of battles that will be fought between Gorbachev, the other members of the leadership and the bureaucracy over the next decade or so.

You will have to count on us to pour through the newspapers and tell you how the battle is going. What I'm watching for is, among other things, a price reform that is true reform and begins to make sense. That is critical. Gorbachev has approached this issue rather cavalierly and rather late.

And also I will be watching to see if, in fact, the central bureaucracy is given a new set of responsibilities consistent with a much more decentralized system.

One of the problems with Gorbachev is he has talked out of two sides of his mouth. On the one hand, he has told ministries not to interfere in the affairs of enterprises. On the other hand, he holds ministers responsible for what their enterprises are doing. You really can't do both of those at the same time. And at some point, he's going to have to choose.

Let me say finally I think one of my success indicators for the reform might be low growth in the short run.

ECONOMIC GROWTH

Senator **Proxmire**. Low growth?

Mr. **Hewett**. Low growth. If the requirements for higher quality and higher efficiency really do take hold, there will be a pause in the Soviet economy. That pause could string out for the rest of this decade.

After the pause, you could begin to see higher growth than you now see. The difficulty we will have both on growth and quality is the following:

Soviet official statistics on growth are not terribly useful and, indeed, I think they are losing their utility as prices begin to move around. They do not know how to deal with price changes in the system.

We will have a terrible problem gauging qualitative change in the Soviet Union. The Soviets have their own quality measures and they will show quality improving. But I just don't trust them. I doubt if Gorbachev even trusts them.

And, yet, to get good, independent quality measures will take a lot of work, both within the government and outside, as we try to develop objective ways to follow this process. We won't ever be able to do it perfectly, but through anecdotal information and some quantitative data, we may be able to at least begin to be able to get a handle on it.

Senator **Proxmire**. Thank you very much, Mr. Hewett.

My time is up. But, you leave us in a dilemma. If we have lower growth, then that's an evidence of success.

I'm sure if it were higher growth, the Soviets and others would say that's a success, too. It's a no lose proposition.

Mr. **Hewett**. You face the same dilemma Gorbachev does. Actually, Gorbachev has shown an inclination to deemphasize growth. For example, last year was a good year for the Soviet economy, with high growth. Gorbachev was one of the people standing up and saying to the other leaders: "Let's not make too much of this." It doesn't mean that the reform is through and now we can sit back and relax.

From his point of view, I think slower growth is a little bit better than more rapid growth because it takes away an issue from the conservatives who want to say: "We don't need reforms because we've managed with what we've done already to get higher growth rates."

He wants to keep that issue from them.

Senator **Proxmire**. Congressman McMillan.

REALLOCATION OF RESOURCES

Representative **McMillan**. Thank you, Mr. Chairman. From your perspective, to what degree do you think that Soviet change depends on a significant reallocation of resources away from military expenditures to the development of technology and a broad based, higher standard of living? And is this, Ms. Schroeder, defined specifically in the document that you referred to in any way whatsoever?

Ms. **Schroeder**. Let me answer the last question first. That's easy.

The document, the reform documents, don't deal with the matter of resource allocation.

To answer the first question, I think that Gorbachev's other goals—not the reforms so much, but his passion to modernize the antiquated capital stock in industry, bringing the Soviet Union's technological competitiveness up to a new level would be benefited greatly by keeping the growth of military spending flat, or even possibly declining.

Those resources can be used to the urgent task of fixing up the rest of the economy.

Mr. **Hewett**. Congressman McMillan, this is an economy in which money is not anywhere near as important as resources, particularly for some high-technology, scarce resources, such as computers.

The civilian economy has a great demand for some of the equipment that goes into the production of computers and computer-controlled machinery. To satisfy that would require the military giving up, if not much in rubles, giving up a great deal in terms of quality. But I do not believe that is the most important thing.

The problem with the civilian economy is not that it is starved for resources; it is that it wastes resources. It is a black hole into which resources fall with no apparent effect.

The most important thing is to change the civilian economy so that enterprises finally are faced with the situation where, if they don't operate efficiently, they fail, or at least they have the possibility of failure. When that situation really exists, that is, when they feel they're under that pressure, then new resources, or even better use of existing resources will fuel this drive.

RATE OF INVESTMENT

Representative **McMillan**. In a number of the documents we've received, including some supplied by Ms. Schroeder, there's a tremendous emphasis on updating the U.S.S.R.'s production capability, which involves capital stock, not just changing behavior patterns.

It's an attempt to increase productivity and advance technologically through capital stock investments. And they're going to have to find resources to enable themselves to do this.

Mr. **Hewett**. That's true, sir, but at the current time, investment in the Soviet Union constitutes approximately a third of their gross national product. This is not a country that has a low rate of investment. It invests at roughly double the rate of most countries.

The problem is that much of those investment resources are squandered. If civilian industry would make better use of investment resources, then the Soviet Union has the possibility to improve economic performance without dramatic increases in investment.

This is not a prediction on my part, but simply a recognition of the possibility of dramatically improving the technological level of Soviet production, primarily with its own resources, without an increase in the rate of investment in that economy.

MILITARY BURDEN

Representative **McMillan**. Mr. Berliner, do you have a pertinent comment?

Mr. **Berliner**. Yes. It's my impression that we don't have very much direct evidence on how the Soviets think about this sort of subject. It's not often discussed in the press. Occasionally, there are inferences from statements of military commanders that lead to the conclusion that there is some group of military people who explicitly recognize that the military in the long run would be better off if they had a breathing spell in the economy.

Mostly, we think about the question you asked from the logic of the situation rather than from the evidence of what the Soviets are thinking about. That thinking was pretty much captured by Ed Hewett's remarks. It's something of a dilemma and I don't think we have a good answer to it.

On the one hand, it's evident that in a nation which has a relative scarcity of highly trained scientists and engineers and top level resources, the extent to which that relatively scarce amount of resources is going into the military R&D and military budget makes it a greater drain on the Soviet economy than it is for us.

Therefore, the benefit to them from being able to reallocate those resources to civilian uses should be greater for them than it should be for us.

On the other hand, once those resources get into the economy, it isn't evident that their productivity would be very high.

The capital output ratio has been very high. It has been rising. I remember one of the important works of Daniel Bond in one of his simulations on reduction in defense expenditures showed that a large reduction in defense expenditures, if reallocated to investment, would have a very small impact on increasing the growth rate, because investment these days is tending not to be very productive.

I think that's the point that Ed Hewett was making. So, on balance, it may not make that much difference.

I would just hazard one comment on this question of quality to which Ed Hewett directs our attention. It's true that there's a sense in which an emphasis on quantity might lead to a shortrun decline in growth rates, as the Soviets measure them.

But the other part of that is that quality is not simply higher proof of vodka or improved restaurant services. Quality also means higher productivity of machinery and equipment.

If that's the form it takes, and I think that's how Gorbachev is thinking about it, the improvement of the quality level of Soviet technology in machinery and equipment would trigger off an increase in the growth rate. So there isn't necessarily a tradeoff, either higher growth or higher quality.

It may in a sense be misleading to regard it as a tradeoff. If they really get the higher quality where it counts, it will take care to some degree of the growth rate.

Mr. **Hewett**. By the way, we don't disagree. It's just that to get these higher efficiencies, you need more efficient capital equipment. And it takes time to produce that, to install it in the plants and get it going.

In the long run, there is no tradeoff between quality and growth. Essentially, they're the same thing. In the short run, there can be a tradeoff.

Senator **Proxmire**. Congressman Fish.

FORCES IN U.S.S.R. AND INFLUENCE OF THE UNITED STATES

Representative **Fish**. Thank you, Mr. Chairman.

This is the third day of these hearings. This is very informative and insightful testimony. And this panel has added to that.

Anyway, I thank you all for what you've told us here. But, in the 3 days of testimony that we've received so far, nobody has said that Gorbachev is going to have an easy time in implementing his programs, his reform.

What I'd like to ask of this panel is, number one, what forces and conditions must be operating, in your view, within the U.S.S.R. for the next 4 years, which I take as sort of a medium figure? Earlier panelists were giving them 4 years. Some said longer.

So what forces in addition must be operating in the U.S.S.R. over this period in order to assure a reasonably successful outcome for Gorbachev.

And, additionally, are there any specific policies or actions that the United States might follow which could either upset or facilitate his program?

Mr. **Berliner**. I agree with Ed Hewett that the influence that the United States will have on progress of the reform is quite marginal. They're going to solve or not solve their own problems.

Our actions will contribute only marginally, particularly in the policies we follow with respect to the Soviet interest in expanding trade in commerce and technology.

If we should seek to strengthen an embargo on the Soviets, on the export of all technology to the Soviets, let's say, this would have some, but I think quite a marginal, impact on the Soviets. It's the old story. Unless we can get the Japanese and the Germans and everyone else to go along, it can have little effect.

So I would say that our impact would be marginal in our ability to assist the reform, assuming that it's in our interest.

Can we gum the thing up? I suppose, if we could imagine a U.S. policy of overt hostility to the Soviets, perhaps a large increase in U.S. defense appropriations, which would look threatening to the Soviets—something of this sort might strengthen the hand of Gorbachev's opponents and make it difficult for him to pursue the reform.

From his own point of view, he would have to respond to any increase in military appropriations. But that doesn't really seem to be in the cards. So it's purely hypothetical.

DOMESTIC FORCES

Representative **Fish**. The first part of my question was about forces and conditions that must be operating within the U.S.S.R. for the next 4 years.

Was your answer: That really is his [Gorbachev's] problem, and it just doesn't affect us?

Mr. **Berliner**. It's his problem, but it's an interesting and important question. I can think of two. One would be if the Soviet people don't behave in the way that glasnost' wishes them to behave and Gorbachev wishes them to behave—what I have in mind is the demonstration protests by Lithuanians, Tatars, artists and ethnic minorities—increasingly political minorities—if they take encouragement from the policy of glasnost' and push their protests to a point that the KGB and the party leadership finds threatening, that could, I think, contribute to bringing the whole thing to a halt.

I think there's a distinct possibility that that may happen. I must say I found the demonstrations in the Lithuanian Republic on the anniversary of the Soviet-Nazi Pact to be quite mind blowing.

Gorbachev is in the position of wanting the people to speak freely, but to say the right things. It's a typical problem of the benevolent dictator. Whether that can happen, that somehow they can contain it, hold the gates that have been slightly opened to the expressions of freedom. People usually want to go further.

The second condition is one that it seems to me isn't going to happen. In Chinese agriculture, which I take as an example of a successful reform, the reform started with Chinese peasants in Sichuan, without the government telling them what to do. They started leaving the communes and setting up their own family farms.

Six months later, the government came along and said, "Well, now you can leave your communes and set up your family farms."

This was a true constituency, a group of people knocking at the walls and saying: We want to change the economic system.

There's no evidence that there are such groups in the Soviet Union. There are no economic interests trying to knock down the walls. The peasants, it seems to me—the Russian, Soviet peasants—don't seem to be eager to take the bit, as the Chinese peasants were.

Possibly there are such groups in agriculture. Gorbachev—I guess we've talked about this before—Gorbachev may be missing the boat here, but he understands the politics better than we do. For there is a general view that there could be a very important shortrun gain to the Soviets from the opportunity for an extensive expansion of private, small-scale agriculture and private economic activity and commerce in consumer goods and services.

That hasn't really been happening. And if he could give that more encouragement, he might be able to show in the next couple of years a substantial increase in places where it tells—better restaurants, better food for consumers. He hasn't really done that. It hasn't really happened.

I think it's a little puzzling why he hasn't launched such a program, that might be quite successful in the short run.

Representative **Fish**. My time is up. Maybe we can get back to this on the second round.

MARKET SOCIALISM

Senator **Proxmire**. Ms. Schroeder, in your previous writings, you've argued that the Soviets were on a treadmill of reforms, moving fast but staying in the same place.

Would you agree that Gorbachev has at least proposed major reforms that could fundamentally change the economy?

Do you agree with Professor Berliner that if the reforms are implemented, central planning will have been replaced by a form of market regulated socialism that, in the CIA's judgment, which they gave us this morning, that Gorbachev's reforms are radical?

Ms. **Schroeder**. Radical is in the mind of the beholder. It can be defined any way anyone wants to. I have argued that this particular package, which is all we've got on these pieces of paper, does not create a market socialism. It does not create markets. It certainly leaves socialism in place.

It does not get rid of central planning because there are far too many elements of the old system left in place.

Senator **Proxmire**. I'll just interrupt to say that isn't this a matter of degree? What you're arguing is that they don't have a market socialism now, but have they moved significantly in that direction?

Or, is it just rhetoric?

Ms. **Schroeder**. Yes, you might argue that they're moving in that direction, but the key elements that it takes to create a market socialism, and we have 20 years of experience of Hungary to tell us an awful lot about this, are simply not yet being put in place and the package as now drawn up is not the kind that will switch them over to where markets tell people and enterprises what to do, instead of bureaucrats.

Senator **Proxmire**. Do you think it's a matter of time? Do you think that as time goes on and Gorbachev keeps pressing that it may develop? After all, it's only been a relatively short period.

Ms. **Schroeder**. Yes. If he changes this particular package, the way those laws are now written, so as to speak, put in place a Hungarian package, then he's likely to have a Hungarian species of market socialism.

But, then he will have the problems that the Hungarians have.

GORBACHEV'S MODEL

Senator **Proxmire**. Let me follow up on that with Professor Berliner.

Can you characterize the model that Gorbachev seems to be following? Is it Hungarian, East German, or Chinese model reform? Are these elements of the Japanese system fathered by McArthur in these proposals?

Mr. **Berliner**. I haven't read the specific legislation that Gertrude Schroeder has. And my remarks are directed toward the picture one gets from the image Gorbachev projects in his major address at the plenum.

When I said that it's a radical reform, I was referring to that vision and not to what's been presently implemented.

Senator **Proxmire**. Does the vision tell you that there is a Hungarian style?

Mr. **Berliner**. The vision was that of Hungarian reform. I can't see in any way that it would be illuminating to think of it as a Japanese reform.

COMPARISONS WITH JAPAN

Senator **Proxmire**. Some people argue it is a Japanese reform. And, of course, that's been a smashing success.

Mr. **Berliner**. Two things.

Senator **Proxmire**. The government still plays a big role in the Japanese economy. Is that right?

Mr. **Berliner**. First, when you say "Japanese reform," I don't know the form that argument takes. But what that triggers off to me—my first reaction—is that the essence of the Japanese economy is a capitalist system based on a series of large autonomous enterprises heavily influenced by government policy, but having their own capital at stake, and highly autonomous; central planning, if it exists at all, takes the form of certain national objectives.

But that is far from describing what the present Soviet economy is like. You're asking whether Gorbachev's vision of the restructured Soviet economy would be similar to a Japanese type of economy.

The major difference will be the difference between state-owned enterprises and privately owned enterprises. And we may, as a matter of fact, if this reform does unfold, perhaps for the first time have an opportunity to observe the success with which a socialist society can operate based on state enterprises unburdened by the Soviet type of detailed central planning.

As I'm talking, I'm beginning to see what you have in mind by a Japanese type of economy. The main difference between Gorbachev's vision and a Japanese type of economy would be that it would be an economy of state-owned enterprises rather than genuinely autonomous enterprises.

In my opinion, that would make a great difference.

IMPLICATIONS FOR THE UNITED STATES

Senator **PROXMIRE**. Ms. Schroeder, both Professor Berliner and Mr. Hewett stated it was in the U.S. interest for the reform to succeed.

Do you agree or disagree?

Ms. **SCHROEDER**. Yes, I agree. I think that the United States should watch with great detachment, not try to interfere on the side of one set of reforms or another, and pursue rather normal—I abstract from defense considerations—normal trade and international organization policies toward the Soviet Union, and consider each particular request of the Soviets to do something or other on its merits.

So I think this is a positive development on, among other things, humanitarian or humane grounds. The Soviet people have suffered grieviously under this system, and I welcome the attempt of some of the leaders to try to improve the lot of those people, which is at least one of their objectives, to bring them into the modern world.

So, in general, yes, I agree. I don't find anything on which to disagree with my colleagues.

Senator **PROXMIRE**. Congressman McMillan.

IMPORT OF TECHNOLOGY

Representative **MCMILLAN**. Let me follow up on the point we were on previously. I had raised the question about reallocation of resources and expressed doubt about the capacity of the Soviets to reallocate military resources to the production of goods and services, or the development of technology.

That may not be what governs though, whether or not they make that decision, because the Soviets are undertaking changes to do things they haven't done before, one of which would be to advance technologically and provide a broader range of goods and services in their own economy.

I do not think it's in our interests to encourage them to move in that direction to the degree that we can because it's in our interests that they do so. And we may have options to do that.

We discussed previously the fact that maybe the INF agreement is simply one signal of change in the U.S.S.R. But the Soviet Union's willingness to seriously negotiate arms reductions might best be gauged by their willingness to reduce commitments to conventional arms, which is probably where the greater part of their resources go.

So I think we can have influence on their behavior to some degree through that mechanism, but perhaps even more. And maybe this is what the Senator was getting at. We've seen other societies of different stripes succeed at acquiring technology and advancing significantly through cooperation with other nations.

The Japanese are certainly ones who have done that and have gone well beyond that. The Soviet system has done that itself in the past; even before the present system, Russia sought to make dramatic gains in the industrial sphere by importing Western technology.

We'd be interested in your views on whether the West should support Soviet desires to import technology—via direct acquisitions or joint ventures—in order to encourage more enlightened policies toward the United States.

Mr. HEWETT. Congressman, I don't disagree fundamentally with what you said. I would still emphasize that the critical variable that I would watch is not the reallocation of resources between the military and the civilian economies, but the course of reform in the civilian economy.

Think of these new resources coming from the military to the civilian economy as a form of technology transfer. The Soviet experience with technology transfer has been mixed. They managed in some areas in the 1970's to import technology and have an impact on industry, energy being a good case in point.

But I think their general assessment—and ours—is that technology imported in the 1970's had a modest impact on economic performance because that system absorbed it without doing much with it. It was not diffused; it was not used well. Turnkey factories built in the Soviet Union operated far less efficiently than identical factories operated in the United States or Western Europe. Because of that, Gorbachev has downgraded the potential contribution of technology transfer to helping him in this reform.

The Soviets do not talk much about foreign economic relations and in particular about their plans for importing technology, but as best I can tell from the speeches and the policies that they have been following they hope that they can make this reform work primarily through Soviet technology and with some assistance from Eastern Europe and very modest technological imports from the West.

So we are not in the position now of a gatekeeper, deciding whether or not we should accede to Soviet demands, really very ambitious demands, for Western technology. To the extent, though, that we are faced with those decisions; for example, in joint ventures, Soviet joint ventures will pose issues for us of licensing, both from COCOM and also directly through our export controls.

We must make those decisions on the merits of the case and forget what impact it might have on the reforms. I can't stress strongly enough how tenuous the links are between a policy decision we might make and the impact on the economic reform. Those chains may have 20 to 30 links in them, and all those links are rubber bands. We don't know what those rubber bands do. We don't even know in some cases which way they go.

So if we sit here and turn a lever to the right or to the left and think that the reform is going to go right or left, we are deluding ourselves.

We need to look at the issue of East-West economic relations on its merits, and here I come down exactly where Ms. Schroeder does: outside of the area of high technology with direct military applications, we should allow commercial considerations to drive those decisions. We have to look at other countries' export controls. Otherwise, our tighter export controls will simply shift business to Europe and Japan.

Representative **McMillan**. Thank you. My time has expired.

Senator **Proxmire**. Congressman Fish.

OBSTACLES TO REFORM

Representative **Fish**. Thank you.

Mr. Hewett, I think you have just answered half the question that I posed, but the first half was what forces or conditions must be operating within the U.S.S.R. over the next 4 years to assure a reasonably successful outcome or, I suppose as Joe Berliner answered the question, or derail a successful outcome?

Mr. **Hewett**. Congressman Fish, I would start by saying that while 4 years is the horizon Gorbachev has chosen, it is probably better for us to think in terms of a decade to 15 years.

Now, in thinking about the forces that might derail or work in the other direction and help this reform along, I would divide them along the following lines. I would say, first of all, Gorbachev has a wide range of opposition that he has to respond to. He knows that. Indeed, some of the most interesting things that have been written as part of glasnost' and published in the Soviet Union are not about the reform, but they are about ways to anticipate opposition and neutralize it.

To Zaslavskaia, the economic sociologist who is so well-known in the West, the important task is to find the opposition, and buy them off or neutralize them.

Gorbachev faces two forms of opposition. One is the bureaucracy itself.

The bureaucracy for its own reasons, in part selfish and in part good reasons, is worried about this reform. Any sensible individual would ask whether the reform might cause a recession, economic chaos, and a loss in control.

The bureaucracy is posing those questions day in and day out. Gorbachev has to deal with that effectively, first of all by putting forth a well-designed reform to minimize the chance for that happening.

Second, during the implementation he must constantly keep his eye on those bureaucrats because they are going to try to nickel and dime that reform to death. This is what Professor Schroeder is talking about. That is, the decrees will not say what Gorbachev thinks they should say. Unless he watches them they will slip a whole new reform right by him.

He actually talks about that. He knows it is going to happen, but it is yet to be seen how much attention he will really pay to it. I think he can handle the bureaucrats. I think he is ready for them. This man knows the system, and he knows how to handle it.

The biggest challenge for Gorbachev is the potential for a coalition between the conservatives and the workers.

The problem with the reform is that it is a very polite phrase for increasing the economic insecurity of the Soviet population. Suddenly Soviet workers will be faced with the possibility of losing their jobs, of having their incomes fall, of seeing other colleagues with much higher income, with having their enterprise closed or having to move from one city to another.

All of this is economic reform, and Gorbachev must allow that to happen and stand fast when the complaints begin. He has to be ruthless and make sure it happens. But in the process he has to convince people there is a payoff in the form of better goods and services.

The conservatives will say that this is not socialism. That is the challenge to Gorbachev, one he is going to have to overcome. We shall have to watch him and see how he handles it.

EAST EUROPE

Representative **Fish**. I sure agree that the same problems also confront the six leaders of the Eastern bloc nations. As they watch the Soviet Union, they will face the same problems at home.

Mr. **Hewett**. The same problems are in the minds of the leaders of Eastern Europe. They have the additional concern that they do not have the support of the population that Gorbachev can draw on when he is in trouble.

Representative **Fish**. Ms. Schroeder, can you add anything to what these gentlemen have said?

DOMESTIC PROBLEMS

Ms. **Schroeder**. Yes. I would like to talk about the internal domestic scene. While agreeing with what everybody has said, I think that the next few years are going to be extremely traumatic for the population itself. Anything that Gorbachev or anybody else can do to give the population the perception that the benefits are coming down the pike will be all to the good.

I would say that the best thing that could happen to Gorbachev would be to get some kind of a breakdown in agriculture. Gorbachev says they are going to discuss agriculture at the next party plenum.

If he can get through, say, a Chinese-type reform in agriculture that will get that albatross off their back and start food supplies flowing, that will be all to the good, as would a really strong push and support for private and cooperative activity. Then people will see that things are looking better. As of now they seem to be looking worse, and this is going to erode the support of the population for the reforms.

Representative **Fish**. Can I enjoy a long count from the chairman here? Do I have time for one more question?

Senator **Proxmire**. Fifteen seconds.

Representative **Fish**. I will wait.

Senator **Proxmire**. I just have a couple of questions, or one question for Mr. Hewett.

Mr. Hewett, how can we possibly expect Gorbachev to maintain his position and his power and his influence if you have on the one hand the uncertainty for the workers, the bureaucrats losing a substantial amount of power, and then slow growth, which you said will be evidence of success?

It seems to me under those circumstances it is hard for them to have a vision of a happy future when it is a less certain future and the results aren't there.

Mr. **Hewett**. I think it would be easier for Gorbachev to live politically with the slow growth scenario than with the high growth scenario. It is my view that one of the most popular things Gorbachev could do right now is get up in front of the Soviet people and say: "Look, between now and the end of this century we are not going to have very high growth, but every year you are going to see higher quality goods and services, a better mix of goods and services, more choice in goods and services than you had the year before." I think that would be a very popular program.

You know, this is a system now in which inventories are higher than in many industrial countries because there are many goods produced but the people just won't buy them at any price any more.

EMPHASIS ON QUALITY

Senator **Proxmire**. But aren't they going to say, well, how do you do this? We are going to have less growth. Doesn't that mean less food, less housing, less clothing, less recreational opportunity, and so forth? Isn't that what growth is?

Mr. **Hewett**. It doesn't have to be, particularly not in the short run. Quality is a very difficult thing to measure in any sense. In the Soviet statistical system, it is particularly difficult to measure. The way you would solve this is to say, "look, if we focus on quality, growth will take care of itself."

Professor Berliner is quite right to point out that in the long run if you focus on quality you will get the high growth. But Gorbachev can argue that the focus should be on quality because that is the most important determinant of our international economic position, the capabilities of the defense industry, and the domestic support for the party.

Senator **Proxmire**. Is this the old Club of Rome zero growth scenario?

Mr. **Hewett**. No. In the first place, Gorbachev has not laid out the scenario. It is mine, and certainly speaking for myself, it is not the Club of Rome's zero growth scenario.

In a way what I am reacting to is our tendency here, and also the tendency in the Soviet Union, to become mesmerized with growth statistics as measures of improvement. Hungary in the 1970's, it is generally agreed, had an improvement in economic performance because of the economic reform, yet the Hungarian growth in the 1970's was in the middle-to-low end for Eastern Europe.

The same thing could happen in the Soviet Union. And if it does, Gorbachev may not be terribly worried about it, and we should not be terribly worried about it either.

Senator **Proxmire**. You may well be right. As an American politician, my experience has always been that it is a lot easier to sell high growth than low growth, certainly in our economy. But as you point out, and point out very skillfully, their economy is extremely different.

GATT AND IMF

One more question, Mr. Hewett. Earlier I raised the question about possible Soviet efforts to join GATT, IMF, and the World Bank.

How would it benefit us and the West to admit them?

Mr. **Hewett**. There are several benefits. One of them is in the process of joining we would have to negotiate a quantum leap in the amount of information we have about the Soviet system, and in the process we might even develop some influence on the system. Better economic information about the Soviet Union could contribute in a number of areas to better U.S. policy.

Second, if we negotiate carefully, we could draw the Soviet Union into participation in finding resolutions to some of the most difficult problems we face in the world.

For example, the Soviet Union is now able to stand on the outside and take virtually no responsibility for finding solutions to the world debt problem. If we brought them into the IMF they would have to become a part of the solution. The same with GATT, concerning trade problems.

The third benefit I see flows from the fact that the U.S. Government has a policy of broadening the basis on which our relationship with the Soviet Union rests, beyond the simple arms control issues. We regard that as good policy, and we regard it as contributing to the probability of a somewhat more peaceful world.

This is one tangible way that we can do that. That is, we should be interested in developing a much more complex relationship with the Soviet Union which would give us many more ways to deal with it, possibly to influence them, if anything, by example rather than being forced to deal with simply on arms control issues.

Senator **Proxmire**. Thank you very much.

Congressman McMillan.

SOVIET STATISTICS

Representative **McMillan**. Just one concluding question.

As experts on the Soviet Union, it seems to be particularly challenging over time to develop accurate and comprehensive sources of information. Have you noticed in your efforts in that regard over recent periods of time a change in attitude or a change in the flow of information that affects your capacity to analyze what is taking place in the Soviet Union?

Ms. **Schroeder**. There are two parts to the answer. The first part of the answer is we have noticed a deterioration or falsification in some sets of statistics, such as those for retail trade which tell what the flow of goods to the consumers is.

This is partly to be explained by the draconian anti-drinking campaign that Gorbachev put into effect, but there are other deteriorations in the quality of statistics.

On the other hand, there has been some small increase in the flow of statistics and a few new things are being seen all the time. They are reorganizing the statistical agency, so possibly the quality of statistics will improve.

Finally, glasnost' has let loose a hail of criticism by Soviet economists themselves of the official Soviet statistics. So hopefully we will see an improvement in their quality and the flow, but not much has happened yet.

Representative **McMillan**. Any other comments?

Mr. **Hewett**. I agree with that. In addition to that, glasnost' has also simply unleashed a blizzard of new information about how the system operates. It is not necessarily in statistics per se, but the beauty of an economic reform of this sort is you will learn a lot about the system since people are arguing with each other. They are arguing with each other in public and in ways and with a degree of frankness that we haven't seen in a very long time.

So you literally cannot read it all. No single specialist can read it all, but it means that together we are forming a picture of the Soviet Union that is far richer and more detailed than we have been able to form in the past.

IMPORT OF TECHNOLOGY

Mr. **Berliner**. I had only one comment on the preceding discussion on the import of technology. One might think of the import of technology for a country which is not one of the technological leaders as a necessary but by no means a sufficient condition for the promotion of one's own technological level.

In fact, the import of technology can be a prescription for remaining permanently behind other countries. It all depends on the innovativeness of the domestic economy.

Japan imports technology for 25 years and in the course of time, because of the internal dynamics of the economy, they become a technological leader.

The Soviets have imported technology under traditional conditions for 50 years, and they will remain a country many years behind.

So the import of technology is not a substitute for an environment of innovative creativity.

SOVIET STATISTICS

Mr. **Hewett**. Congressman, could I add to your question on statistics just briefly to make one point?

As we move, as inevitably I think we will, toward negotiation with the U.S.S.R. and international economic organizations, this is an area where we can have an effect, one where we should push the Soviets. We should require from the Soviets a full set of national income accounts on a GNP basis, including accounts on defense expenditures, and these data should be fully documented so that the rest of the world can see how they are constructed and can learn from them.

That is one of the areas in which we can get very tangible benefits out of negotiations with the U.S.S.R. in this important area.

Ms. **Schroeder**. Amen, I say.

Representative **McMillan**. Thank you very much.

Senator **Proxmire**. Congressman Fish.

COALITION FOR REFORM

Representative **Fish**. Thank you, Mr. Chairman.

My question really follows what we were taking about earlier during my time about forces and conditions operating in the country. Over the last few days we have been told that Mr. Gorbachev lacks a political power base and can't do all this without that, that the regional Soviet leadership are not his appointees.

Mr. Hewett has commented optimistically that he thinks he can overcome the bureaucracy.

We have been told he is popular but there is no popular movement behind his efforts and that he faces a real problem if his economic reforms lead to a coalition of conservatives and workers.

Well, he certainly cannot possibly succeed or fail alone. So we have read very little about the persons or groups who constitute the governing political coalition, and I wonder if any of you are prepared to speculate as to the nature of the support which individuals and institutions play.

Mr. **Berliner**. In my prepared statement I have a brief reference to the kind of coalition constituency that appears to support him. It is not linked in a social group. It consists of scatters of individuals, among economists, for example. You can't say that economists as a group are behind him. There are some economists of a particular technical and ideological persuasion, some economists, some political leaders, some party officials at the top, many of them his appointees, but by no means the whole party leadership. There are some scientists and intellectuals, but again not all. And then evidently there are some military officers but you can't say that all military officers are his supporters.

The point is that the people who form his support are individuals who come to this by conviction rather than by virtue of their interest as a group. There is an absence of a constituency of interest, of people pushing him to move faster because that is really where their bread and butter lies.

I share the view of your former testifiers that there seems to be a weak social base.

EFFECTS ON PRODUCERS

If I may just make one other comment?

I propose that part of the reason for it is that the benefits of economic reform, as Ed Hewett has outlined them, will redound to the whole Soviet population as consumers. In their roles as consumers life will be better for them. It will be a pleasure to go to a Soviet restaurant.

However, the reform is threatening to virtually all the population in their role as producers.

Now, it is sort of a general principle of political action that people's interests are primarily tied up in their producer roles rather than their consumer roles. That is why in this city there are powerful lobbies of businessmen and laboring men and producers, but you don't have powerful lobbies of consumers.

That is the political problem. Everybody stands to gain as a group, but each production constituency—workers who may lose their jobs, managers who face competition they have never had to deal with before, party leaders who may find there are people now in their province who are richer than they and over whom they have no control—all feel threatened, and I think that is part of the problem.

It is a consumer beneficent reform and not a producer beneficent reform, as the Chinese reform was for Chinese peasants.

SOURCE OF GORBACHEV'S STRENGTH

Ms. **Schroeder**. May I just say one word here?

I am not a political analyst, needless to say, but one thought has struck me about this. It seems to me that one of the greatest sources of Gorbachev's strength right now is that he has a program. Nobody else has come up with a program.

Everybody agrees the economy was a mess and something needs to be done. Nobody else has said, look, this is what should be done as opposed to what you are proposing. So it is therefore, in my view, very important that Gorbachev should be able to show some success.

So if we have slow growth or declines in output and the consumers aren't better off, I think it is going to be very dicey for Gorbachev personally.

OUTLOOK FOR GORBACHEV

Mr. **Hewett**. Congressman Fish, I don't want to minimize the difficulties Gorbachev faces, but I frankly get nervous when people start talking about a man who might disappear from the scene in 2 or 3 or 4 years because of political opposition.

I mean, he didn't parachute down from Mars. He was chosen by the people on the central committee of the Communist Party of the Soviet Union. He was chosen knowing full well what he had in mind because he had been running the economy under Chernenko for at least a year and he had begun to assume those responsibilities under Andropov.

He is also, remember, a man whose political fortunes rose while he was managing Soviet agriculture during the period in which they had more bad than good harvests. So if anything, we should respect him as a politician. In fact, I respect him more as a politician than as an economist, and those folks who are telling me now that he may not be around for very long would have told you a few years ago that Gorbachev had no chance of becoming General Secretary.

This is a dark horse who is impressing all of us with his political abilities, and particularly his ability to consolidate power.

He has now appointed new leadership in every single important central institution that guides the economy, most of the ministries that guide the economy. He is now putting his people in the very important central committee staffs.

He has, in his responsibilities as head of personnel which reach back to Andropov, appointed many people at the regional level. They are very important for him as General Secretary.

Ultimately, his problem is going to be trying to focus on those things which consumers will look for. They will look for progress in the reform.

Since he first announced the twelfth 5-year plan in 1985–86, there have been two times in which he has increased targets for housing, so that now the amount of housing that will be built in this 5-year plan is something like 5 to 7 percent higher than it was supposed to be a mere 18 months ago. There he is focusing on an issue that really is important to Soviets, and that is that they cannot get apartments. There are many young people who have no prospect in this decade, even if they are married, of living in their own apartment. He is going to try to work on that.

He is working on those sorts of issues, where they will see some impact from the reform. The other thing he has got going is what Gertrude Schroeder points out. There is no alternative program out there.

Representative **Fish**. I didn't think he was a Martian, but I note from your answer that he is not the Lone Ranger either.

Mr. **Hewett**. He is not the Lone Ranger.

Senator **Proxmire**. Thank you very, very much. It is an excellent panel, and we deeply appreciate your testimony. We are in your debt.

The subcommittee will reconvene on Monday, October 5, to hear testimony from the State Department.

[Whereupon, at 12:30 p.m., the subcommittee recessed, to reconvene at 10 a.m., Monday, October 5, 1987.]

ECONOMIC REFORMS IN THE U.S.S.R.

MONDAY, OCTOBER 5, 1987

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON NATIONAL SECURITY ECONOMICS
OF THE JOINT ECONOMIC COMMITTEE,
Washington, DC.

The subcommittee met, pursuant to recess, at 10:05 a.m., in room SD-538, Dirksen Senate Office Building, Hon. William Proxmire (chairman of the subcommittee) presiding.

Present: Senator Proxmire and Representatives Solarz and Fish.

Also present: Richard F Kaufman, general counsel.

OPENING STATEMENT OF SENATOR PROXMIRE, CHAIRMAN

Senator PROXMIRE. The subcommittee will come to order.

This is the fourth day in a series of hearings that we are having on the Soviet economic reforms.

The official Soviet news agency, Tass, reports in an October 1 dispatch on General Secretary Mikhail Gorbachev's recent speech in Murmansk. In his speech, Mr. Gorbachev notes the widespread interest outside of the Soviet Union in the economic reforms he has undertaken. The Soviet leader specifically cites these hearings of the Joint Economic Committee on his proposed economic reforms and the fact that a spokesman from the administration, the Defense Department, the CIA and the DIA have testified.

Mr. Gorbachev states:

> It is even good that officials at such a level want to gain a thorough understanding of what takes place in the Soviet Union and what our reorganization means for the rest of the world and the United States itself.

Of course, it's interesting and significant that the Soviet leadership is following closely U.S. reactions to the changes occurring in the Soviet Union. Mr. Gorbachev is exactly right that policymakers in Washington are focusing on the strategic implications of Soviet reorganization; that is, what it means for us.

There is a growing consensus that Gorbachev's reform program is the most sweeping since Lenin's reforms of the early 1920's. He's apparently trying to escape fundamentally the Stalinist system of rigid central planning. There are many pitfalls in his approach, including possible political opposition and temporary economic disruption. Most experts would agree that positive economic results will not show up until the mid or late 1990's at the earliest.

Gorbachev's present intentions concerning reorganization seem clear. Whether he succeeds or fails remains to be seen. In either event, there will be serious consequences for the United States with respect to our relationship to the Soviet Union, the Western alliance, and national security, trade, and a host of other areas.

Our first witness this morning is Thomas Simons, Jr., Deputy Assistant Secretary of State for Europe. Mr. Simons will be followed by a panel of private experts whom I will introduce later.

Mr. Simons, I would like you to summarize your views in 10 minutes. Your entire prepared statement will be placed in the record. Go right ahead, sir.

STATEMENT OF THOMAS W. SIMONS, JR., DEPUTY ASSISTANT SECRETARY OF STATE FOR EUROPE

Mr. SIMONS. Mr. Chairman, thank you very much. It's a privilege to be here on behalf of the Department of State to comment on these important issues. I can't believe that Mr. Gorbachev was waiting for the State Department's testimony before drawing his final conclusions on what these hearings mean. I notice he didn't mention us, so it's doubly pleasurable to be here and I would also thank you for allowing me to reschedule before being here because of the meetings between our foreign ministers.

Mr. Chairman, my prepared statement is available to the committee, so with your permission, I will summarize it.

We approach the issues arising from the economic reform in the Soviet Union partly with an interest in what is going on, but of course mainly with an interest in what the implications are for U.S. policy.

U.S. POLICY

We have developed in recent years what we think is a coherent framework for policy vis-a-vis the U.S.S.R. It is based on the principles of realism, strength, and dialogue. We need strength in order to counter hostile Soviet actions that threaten the U.S. and allied security. We need dialogue with the Soviet Union in order to see where it is possible to cooperate in this late 20th century between two superpowers whose relationship is going to remain naturally competitive. And we need realism both in terms of what can be expected and of what the differences between our two countries are in order to maintain a firm base for both strength and dialogue.

The major objective of U.S. policy is a more stable and constructive relationship with the Soviet Union over time. In order to do that, we have set forth an agenda which covers all the critical issues between the two superpowers. Hence, arms control and national security issues, so-called regional issues, how to deal with tensions in third areas, the advancement of human rights, and the range of bilateral issues, including contacts between our peoples, and of course also economic relations.

This is the framework into which we fit our interests in the economic reforms going on in the Soviet Union or being attempted in the Soviet Union.

I would like to make four points. Let me run through them briefly and then touch on them a little bit more later on.

REFORMS SHOW PROGRESS

The first point is that for the long run Gorbachev's reform program appears to us to hold some promise—we state this cautiously, but some promise for a freer and more benign Soviet Union, a Soviet Union which is more relaxed internally and is a more responsible member of the international community than has been in the past.

CORE GOALS UNCERTAIN

My second point is that for the short term the reform program which is before us now is indeed very far reaching in its implications, but uncertainty persists with regard to its core goals and the breadth and depth of the support that it can muster in Soviet politics.

REFORM PROGRAM WON'T BRING ABOUT FUNDAMENTAL CHANGE

The third point is that it does not seem to us that the present reform program, as far reaching as it is in its conception, will resolve the Soviet Union's basic economic problems. It does not appear to us at this point that even if entirely implemented that the Soviet Union will become a fundamentally different—a qualitatively different kind of competitor for the United States from what we have before us today.

U.S. MUST PREPARE FOR SUCCESS OR FAILURE

Finally, in terms of its implications for the United States, we believe that the United States needs to be prepared either for success or failure of this reform effort. However it goes, we need to have a policy framework widely based, supported on a bipartisan basis, to allow us to define our interests and to promote and maintain our interests, whatever happens there.

POLITICAL OBJECTIVES FOLLOWING REFORM

Let me touch a little more on each of these four points. We do believe that the reform program may represent a first step toward a larger degree of economic and political freedom inside the U.S.S.R. Alternatively, it could also be the beginning of a determined effort to upgrade Soviet military potential.

As these things go, as political leaderships go, probably the attempt will be to achieve both as they go on. But those would be the two trends of greatest concern to the United States.

We do indeed have a stake in how these scenarios play out. The hope that the U.S.S.R.'s aggressive behavior could be contained and that the Soviet Union could evolve over time into a freer society and a more responsible presence in world affairs has been at the core of U.S. foreign policy since World War II and continues to be.

We feel that in recent years the hope of a favorable evolution has been advanced by strong and forthright U.S. policy approaches and buttressed by the observed momentum of economic and political freedom around the world.

MOMENTUM OF REFORM

We believe that there is a genuinely new generation of leadership coming to the fore in the Soviet Union. We note that the momentum of reform has clearly grown since Mr. Gorbachev became General Secretary.

At the same time, the wake of Soviet history and present realities require us to be extremely cautious in being hopeful about these positive trends. There are formidable barriers—values, interests, habits, and structures—in the Soviet life to that kind of evolution. The concrete economic measures that the Soviet Union has taken under Gorbachev still leave those barriers in place, so caution is enjoined.

With regard to Gorbachev's mandate, the short-term mandate for reform, it is driven by an urgent sense which we believe is very widespread throughout the Soviet elite that the U.S.S.R. needs to shake itself out of a precrisis situation of economic stagnation, technological backwardness, and social malaise.

This consciousness of incipient crisis has existed since the 1970's and this reform effort builds upon it.

The present trend suggests that Gorbachev's mandate for change is growing stronger. In the first years of his tenure, he concentrated on the so-called human factor, avoiding the structural change, avoiding serious debate about alternative forms of resource allocation, pushing, for instance, tough discipline, the implementation of outstanding legislation on the economy.

Since last year, however, he has gone beyond that, laying out a program for far-ranging and deep-scouring economic reform and extending beyond economic reform to so-called glasnost', the transparency policy with regard to public debate, and to democratization in an attempt to mobilize and engage a citizenry which has been more or less passive so far.

JUNE PLENUM

The plenum of June this year was a very important moment in that strengthening. He emerged in a stronger political position and secured the blessing of the central committee, which is the primary political body there for a comprehensive program.

The program was adopted. The plenum gave overall approval to 11 draft decrees detailing the reform, and since then, all but one of those decrees have been made into law. His speech at Murmansk last week—which you mentioned because indeed it suggested very close attention to the proceedings before your committee in terms of American opinion—the focus of that speech was, nevertheless, a call for implementation in practice of the kind of reform program that has been set forth in legislation.

At the same time, this extensive mandate for change is neither etched in stone nor universally recognized as definitive. A very great deal depends on Gorbachev individually, personally. Soviet leadership is like that. The kinds of rumors and speculation which arose during his prolonged absence indicate the importance of his personal role in this.

OBSTACLES TO REFORM

There is resistance from the elite, within the elite. It's an obstacle which is publicly acknowledged by Gorbachev. The attitude of two powerful institutions—the military institution and the security policy institution—is open to some question. I mean their posture vis-a-vis the reform.

At the popular level, there is evidence of skepticism that Gorbachev's reforms are going to make any difference. And it seems to us, as it seems to many Soviets, that the test is going to be in terms of positive results.

There is a problem with the reform that it demands a long-term effort with deferred results in terms of welfare and efficiency, and that will be a problem—this absence of an immediate payoff is going to be a problem as we proceed.

It would be a mistake, we think, to ignore the incentive effect of changes outside the economic area—democratization, the kind of democratization program that in its incipient stages is capable of winning as well as losing hearts and minds. But early economic payoff will be a key ingredient to overall success and the prospects are by no means clear.

The Soviets themselves emphasize that restructuring is a long-term process, but full implementation is going to be difficult at best. Even if everyone does their best, it will not be easy to implement. It has been reported that some 15,000 laws and regulations are going to need to be changed to accommodate the new socialist enterprise law and decrees. Thousands of managers are going to have to learn and implement new habits even as they are trying to increase efficiency and put these reforms into effect.

What the regime is faced with is something like rebuilding a kitchen, applying unfamiliar and incomplete recipes, and cooking for the guests all at the same time. It's a daunting challenge to them.

PROBLEMS OF IMPLEMENTATION

Implementation will raise new problems. Income disparities, unemployment, and inflation are all expected to increase and one of the social compacts of the post-Stalin regime in the Soviet Union has been full employment, job security. To the extent that this is threatened, it will arouse debate which goes well beyond the economic sphere and beyond the elite. Therefore, we are in uncharted waters. At this point it seems questionable to us that the full implementation of the economic reform will make the Soviet Union a fundamentally different place.

The purpose of the reform after all is not to introduce free market economics, but to strengthen centralized economic management and to make it more efficient. Therefore, the problem which has plagued Soviet leaders since the 1950's—how to find a viable nonmarket alternative to a command economy which will both ensure central control and promote efficiency—remains entire and the odds are rather low that this objective will be realized.

IMPLICATIONS FOR THE UNITED STATES

The policy implications for the United States, we feel, are—the prescription for us is "steady as you go." On the one hand, Gorbachev's determination to revitalize the economy refreshes our hope that the U.S.S.R. may become a better place both for itself and for its neighbors on this shrinking planet. But there is also the prospect that an economically more robust U.S.S.R. could become a more formidable foe or adversary.

The implementation period ahead for Gorbachev's economic program will help us to gauge which way things are heading.

We are alert to what is happening there. We recognize its importance and potential importance for us and our allies and indeed for the world. We need to be ready for developments in either direction and we are.

We believe that the policies we follow over the next few years will be a challenge and opportunity for Gorbachev and his fellows in the leadership to take positive concrete measures in Soviet domestic and foreign policy.

Our policy is in place. We have a clear and comprehensive agenda based upon our interests. To the extent that the Soviets are capable of and willing to work with us on that basis, we will move forward.

Mr. Chairman, I think probably my 10 minutes are up, so let me save further individual comments for the question period.

[The prepared statement of Mr. Simons follows:]

PREPARED STATEMENT OF THOMAS W. SIMONS, JR.

Introduction

U.S. policy towards the Soviet Union is based on the principles of realism, strength and dialogue. We need strength to counter Soviet actions which threaten U.S. and allied security. We need dialogue to develop peaceful and just solutions to problems and to encourage the USSR to fulfill its international obligations and play a responsible role in the world community. And we need realism to remember that the principles of strength and dialogue must be applied together for us to obtain our objectives.

The overall objective of U.S. policy towards the Soviet Union is a more stable and constructive relationship. We want progress across four critical areas:

-- the pursuit of verifiable and stabilizing arms reductions,
-- negotiated solutions to regional conflicts,
-- the advance of human rights,
-- and expanded contacts between our peoples.

It is against the background of these policy principles and objectives that I will address the significance of Gorbachev's economic reforms, their likely outcome, and the implications for the United States. I aim to make four points.

(1) For the long run , Gorbachev's program holds cautious, and I emphasize cautious, promise for a freer and more benign Soviet Union.

(2) For the short term, Gorbachev has in place a far-reaching economic reform program. But his core goals, and the breadth and depth of the support he can muster, are still unanswered questions.

(3) Gorbachev's present reform program will not resolve the Soviet Union's economic problems. Instead, this initial phase of reform is more likely to bring either reaction or further reform.

(4) The implication for the U.S. is that we should stay our present policy course, with enhanced appreciation for the need of effective interagency and executive-legislative cooperation to implement clear and coherant policies.

Let me now address these four points in further detail.

I. Significance of Gorbachev's Reforms

Over the long run Gorbachev's reforms may represent a first step towards a larger degree of economic and political freedom inside the USSR. They may also be the beginning of a determined effort to upgrade Soviet military potential without changing the basic nature of the state.

These alternative scenarios are what makes Gorbachev's economic reform program -- and the related themes of "openness" and "democratization" -- so interesting to the Western world: On the one hand there is hope that the reform process -- intentionally or not -- might lead to a more democratic Soviet Union with a more responsible foreign policy. On the other hand there is concern that a more vital Soviet economy will simply increase the military might of a basically unchanged Soviet regime.

We have a big stake in which of these scenarios occurs. The hope that the USSR, if "contained", could evolve over time into a freer society and a more benign presence on the world scene has been at the core of U.S. foreign policy since World War Two. In recent years such hope has been advanced by strong and forthright U.S. policies, and buttressed by the observed momentum of economic and political freedom around the world. Inside the Soviet Union, a new generation of leaders is coming to the fore which is less burdened by experience of or responsibility for the Stalin era. The new generation also knows that thirty years of tinkering with Stalin's economic legacy have failed to close the economic gap with the west. With the arrival of this new generation, and after years of stagnation in Soviet economic policy and performance, the momentum of reform has clearly grown since Gorbachev's rise to General Secretary.

However, the weight of Soviet history and present realities require that our hopes for a freer and more benign USSR remain extremely cautious. The values, interests, and habits built up over 70 years of Soviet life -- not to mention 1000 years of Russian history -- constitute formidable barriers to the progress of economic and political freedom. So do Soviet, or Russian, concerns about centrifugal forces within the multinational Soviet state as well as in Eastern Europe.

The concrete economic measures the Soviet Union has taken under Gorbachev still leave those barriers in place. The Soviet Union is still a country where something as basic as freedom of movement is a privilege and not a right; it is still far from being at peace with itself or the rest of the world. As President Reagan put it, "while we acknowledge the interesting changes in the Soviet Union, we know that any Western standard for democracy is still a very distant one for the Soviets.... That is why we know we must deal with the Soviet Union as it has been and as it is, not as we would hope it to be." I will return at the close of my statement to some practical implications of this imperative.

II. Gorbachev's Mandate

For the short term, it is clear that Gorbachev is driven by an urgent sense that the USSR needs to shake itself out of a "pre-crisis" situation of economic stagnation, technological backwardness, and social malaise. How far Gorbachev is determined to go, and how much support he can find and maintain among the Soviet elite -- including key institutions like the KGB and military -- and among the Soviet people, are still unanswered questions.

Present trends suggest that Gorbachev's mandate for reform is growing stronger. The momentum of change has accelerated over Gorbachev's tenure as General Secretary. Like Andropov in 1983-1984, Gorbachev began with a strong call for forward progress but reliance on remedies from the past. In 1985-86, he initially pushed for tougher discipline and for implementation of outstanding legislation on the economy. This included a set of measures approved in 1979 but never carried through, which western analysts had already seen as an effort to finetune, rather than loosen, the command economy. By late 1986 the prospects for serious reform -- and for Gorbachev's effectiveness as General Secretary -- did not seem that bright. Not a whole lot was happening, and Gorbachev's urge to go beyond rhetoric appeared to have been stymied at the January 1987 Central Committee plenum.

The June plenum, however, confirmed a dramatic shift. Gorbachev emerged with a stronger political position and official blessing for a comprehensive economic reform program which was largely crafted by his own team of economic advisors. Three close associates were added to the Politburo. Gorbachev's own report to the plenum was a strong and lucid economic reform statement. The plenum adopted a comprehensive program for economic reform, and gave its overall approval to 11 draft decrees detailing the reforms. Since the plenum, all but one of the 11 implementing decress on economic reform have been made into law and published. (The single and significant exception concerns reorganization of the Council of Ministers, ie, the bureaucracy whose role is to be reduced by the reforms.)

The plenum further announced that agricultural issues would be addressed at an upcoming plenum (perhaps this October). It approved Gorbachev's proposal to hold the first party conference in 47 years next June, to further examine economic policy and performance, the role of party organizations in deepening the process of reform, and measures to further democratize the party and society. In addition, the plenum debated and the Supreme Soviet has since enacted the new Law on Socialist Enterprises, along with two other laws calling for public discussion of important issues and giving citizens the right to sue officials who infringe upon their rights.

All of the above constitutes an extensive mandate for change. We believe, however, that Gorbachev's mandate is neither etched in stone, nor universally recognized as definitive inside the Soviet Union. Let me outline some weaknesses in that mandate:

-- A great deal depends on Gorbachev individually. He frequently appears to be well out in front of his troops. And, just as was the case during Brezhnev's last years and the brief Andropov and Chernenko interregnums, any prolonged absence of Gorbachev from daily Moscow political life generates speculation about the leader's physical and political health. Such speculation is symptomatic of the contingencies of any Soviet leader's political mandate. It illustrates the highly personalized nature of any "reform" effort in the USSR. There is simply no institution capable of carrying on without leadership from the top.

-- Resistance from the elite -- from ideological conservatives and from threatened bureaucrats -- is an obstacle publicly recognized by Gorbachev himself. The degree to which that resistance is latent and inchoate, or explicit and organized, bears close watching.

-- More specifically, the attitudes of two powerful institutions will remain crucial to Gorbachev's prospects as his reforms move forward. The Soviet military appears to have stoically absorbed its unusual public humiliation after the Cessna incident -- but remains a question mark. The KGB, judging from the recent public utterances of its chairman Vladimir Chebrikov, appears to have some rservations about Gorbachev's policy directions in "openness", "democratization", and "restructuring".

-- At the popular level, there is evidence of scepticism that Gorbachev's reforms are going to make any difference. There is a public perception that Gorbachev is simply "another Khrushchev" bearing promises of a brighter future. What's more, Gorbachev is asking for harder work now and promising a better life later on, whereas Khrushchev's tenure saw considerable improvement in living standards. To the extent that Gorbachev's reforms require popular support to move forward or to work, such scepticism -- whose extent is of course hard to gauge -- will have to be overcome.

-- To preserve and maintain his mandate for reform, Gorbachev will need to produce positive results sooner rather than much later. However, a central weakness of his economic reform program is the absence of an immediate pay-off. Overall, the reform program projects medium-term gains in efficiency, quality and output in exchange for wrenching adjustments now. This is perhaps realistic; it may also be disheartening At the popular level, the more efficient workers are promised increased wages, but even the early winners under the reform are unlikely to see any early improvement in their living standards. Desired consumer goods and services will remain scarce, especially under the priority Gorbachev has assigned to increased investment in capital goods.

Gorbachev might get a quicker pay-off at the popular level if he could widen the narrow opening made thus far for individual and cooperative enterprise ; or if he could provide more radical incentives for farmers or wider openings for direct commercialization of farm produce.

It would also be a mistake to ignore the incentive effect of changes outside the economic area: "democratization" is capable of winning as well as losing hearts and minds. Nevertheless, early economic payoff will be a key ingredient to overall success of the reform effort, and the prospects are by no means clear.

III. The Likely Outcome

Although he is in a hurry, Gorbachev and other Soviet leaders recognize that "restructuring" will be a long-term process. They describe it in terms of preparing the USSR's entrance into the 21st century. We can however address the likely outcome of "restructuring" in its initial phase. Full implementation will be difficult, and if achieved will not resolve the Soviet Union's economic problems.

Gorbachev's economic reform program as outlined at the June plenum seeks to put a "New Economic Mechanism" in place by 1991. The reform program is comprehensive and ambitious. But Gorbachev's "New Economic Mechanism" is still an abstract structure which must be applied to a very concrete, and conservative, economy.

This will not be easy even if everyone does their best. The reform program outlined at the June plenum and in subsequent decrees is an elaborate theoretical framework of how the economy should be administered and function. There is a "Rube Goldberg" quality to the scheme created. There are many ambiguities and contradictions, and very few details about how the economy will actually work in practice. Some 15,000 laws and regulations reportedly need to be changed to accommodate the new socialist enterprise law and accompanying decrees. A new set of guidelines and hierarchies will have to be explained to hundreds of thousands of ministerial bureaucrats and plant managers, who will have to relearn by trial and error where their interests lie. New occupations will need to be found for thousands of central planners and administrators, while those who remain will have be reconciled to continued responsibility for, but less leverage over, the economic performance of subordinate units. Thousands of plant managers are going to have to learn new skills, if plant management is really going to devolve and to be based on what the Soviets describe as economic instead of administrative principles. Throughout these throes of restructuring, central administrators, plant managers and workers are all enjoined to increase both the quality and the quantity of production. All this is akin to rebuilding the kitchen, applying unfamiliar and incomplete recipes, and cooking for guests, all at the same time.

Meanwhile, the process of implementation will raise new problems. Income disparities, unemployment, and inflation are all expected to increase. This will erode the "social contract" of the post-Stalin era. Full employment, job security, has been widely considered one of the primary achievements of "socialism" in the Soviet Union, even if it meant widespread underemployment. The phenomenon of frictional unemployment will arouse debate that may well extend beyond the economic sphere and beyond the elite. Resulting social strains will complicate the feedback on reform implementation and influence the pace and scope of implementation. Other, perhaps less foreseen, complications are likely to emerge from the application of economic reform to the Soviet Union's fifteen constituent national republics. Some nationalities may want to push the reform at a pace that goes beyond what Moscow can easily accommodate. Others, if "glasnost" progresses, may press regional resource allocation issues more aggressively than in the past.

In short, Gorbachev's "new economic mechanism" is uncharted territory in practical terms; it is likely to accentuate social and national strains; and it will certainly be influenced by discoveries made as its details are filled in.

Finally, even if it is fully implemented, the present reform program is unlikely to produce a stable "economic mechanism" conducive to rapid growth and technological innovation. Although it promises considerable decentralization, the reform program retains the basic character of Soviet economics. Central authorities, and not the 'invisible hand' of free-market economics, will set priorities, control prices, and monitor performance.

In this sense, Gorbachev's present reform perpetuates an objective which has stymied Soviet leaders since the 1950s: how to find a viable non-market alternative to a command economy which will both ensure central control and promote efficiency. The odds are low that this elusive objective will be realized. It is more likely that by the early 1990s, when the "New Economic Mechanism" is scheduled to be in place, the Soviet economy will either be settling back into old familiar patterns, or be pushed further along the path of reform.

IV. Policy implications for the U.S.

I would like to conclude by restating the significance of Gorbachev's economic reforms and then addressing the practical implications for U.S. policy.

Gorbachev's determination to revitalize the Soviet economy refreshes our hope that the USSR may evolve into a freer and more benign state, but also heightens our apprehension that an economically more robust USSR could become a more formidable foe.

The implementation period for Gorbachev's present economic program will help us gauge which way things are heading. In the meantime, neither our hopes nor our apprehensions are likely to be fulfilled over the next three years. Gorbachev's short-term economic policy objectives will be difficult to achieve, and the results are almost certain to be inconclusive. The basic characteristics of the relationship between the U.S. and the U.S.S.R. will continue to pertain. The Soviet Union will remain the powerful adversary we have successfully contained for over two generations.

We believe the policies we follow over the next few years should present Gorbachev's activism with the challenge and opportunity to take positive, concrete measures in Soviet domestic and foreign policy. The basic principles and objectives of our policy towards the Soviet Union are well-framed to defend and advance our interests and the image we have of the world. The fact that the Soviet Union is embarking on a transition, and that Gorbachev will have to engage us in dialogue across the four issue areas of concern to us, will allow us to make our pursuit of US interests more active.

At a mundane but not insignificant level, one implication is that we are going to be a good deal busier than before.

More generally, it will be imperative that we maintain an optimum balance between strength and dialogue, and be alert and consistent in our policy execution, to insure that any influence we can exert on the direction of the Soviet Union's transition will be positive in terms of our interests.

It will also be imperative that we remain realists. We must respond to concrete acts, not to rhetoric. We must think in terms of direct US interests, and not in well-intentioned but illusory terms of "helping Gorbachev reform". Our leverage over internal Soviet developments is neither powerful nor direct, and there is nothing to be gained by offering preemptive concessions in the hope they will promote positive change.

At the same time, however, we must also avoid sending signals to the Soviet leadership which could inhibit positive change without advancing direct US interests.

To enhance executive-legislative cooperation in this regard, I would like to raise some legislative issues that are of concern to us now. One aspect of the bilateral relationship with the Soviet Union is trade. To express our commitment as a nation to the concept of human rights, Congress has clearly established the conditions for a meaningful expansion of such trade with the Jackson-Vanik and Stevenson Amendments, which this administration supports and implements. At the same time, however, Congress sometimes supports measures whose practical effect is economic warfare against the Soviet Union, and which reduce Soviet incentives to move forward on human rights or to undertake economic reforms conducive to efficient and mutually beneficial trade.

For example, we believe the Garn/Proxmire amendment to the Senate Trade Bill is unnecessary. Bank credits to the USSR already face a host of restrictions, and those loans that are extended largely go to support direct US exports. Official USG-backed credits already are essentially prohibited by the Stevenson Amendment.

Another amendment to the Trade Bill which causes us concern and which could have considerable negative impact on our trade relationship with the USSR starts from the concern we all have about the forced labor question. The amendment would make the legislative determination that seven categories of goods produced in the USSR are produced under conditions of forced or indentured labor and therefore would be banned.

Existing legislation already addresses the question of imports of goods produced by such labor. And the Administration is clearly committed to enforcing that legislation. However, studies of the available evidence have failed to establish that such goods are being imported into the US from the USSR. If we find such evidence, we would move quickly to ban such imports. Legislating a ban without adequate evidence on which to make such a finding of fact looks like economic warfare, pure and simple.

This state of affairs is exacerbated by a lack of movement on another item. Two years ago, this Administration suggested to the Soviets that, in return for improved conditions for US businessmen in Moscow, we would work to eliminate the 36-year-old ban on fur skins. The Administration's bill was shelved at the end of last year's session and has been reintroduced. It is small in terms of trade, but symbolic of the Congress' willingness or unwillingness to provide incentives as well as sanctions in trade with the Soviet Union. I hope that you will agree that the time has come to remove the ban of fur skins and that you will support the Administration's proposal.

I have taken you from the grand issue of whither the Soviet Union down to some relatively minor details of executive-legislative cooperation. However, just as western analysts of current Soviet trends like to underscore that it is the details that will determine the final shape of Gorbachev's economic reform program, so too would I like to emphasize that details will be critical to the evolution of US-Soviet relations. To get those details right, we will need the support and understanding of Congress.

Thank you. I will be happy to respond to your questions.

ENDURANCE OF CENTRAL CONTROL

Senator PROXMIRE. Thank you very much, Mr. Simons. We very much appreciate your presentation.

You say that the Gorbachev program offers both a promise for a freer and more benign Soviet Union. But others would argue that the one-party state, with no significant elections, with total control over every aspect of the Soviet economy by the politburo remaining, although there is some decentralization, that there can be no real freedom. There's no evidence that Soviet rule at home or in Eastern Europe is becoming benign or that its policies of military superiority or expansion have changed in any fundamental way.

How would you respond to that criticism of the freer and more benign thesis?

Mr. SIMONS. We agree with it, Mr. Chairman, up to now. We have not yet seen fundamental changes in that basic structure of Soviet government and politics which we believe has contributed to making the Soviet Union an aggressive and irresponsible force in world affairs.

However, the kinds of things which Mr. Gorbachev and his colleagues in the leadership are attempting to do, say they wish to do, ought over time to loosen some of those rigid centralized structures. The kind of economic reform which they have projected is not going to permit the same degree of central control if it is implemented that has pertained in the Soviet Union since the late 1920's.

Over time, if elements of Soviet society develop their decision-making authority, their autonomy, this will make inroads into that extreme centralization.

Senator PROXMIRE. Let me just interrupt to say, I don't disagree with the possibility that there may be less centralization, but my question is, does this really indicate any benign change, any change of a better nature or of a more friendly, more positive approach to the world, the kind of thing where they wouldn't perhaps invade an Afghanistan or exercise the same kind of pressure and suppression and repression in Eastern Europe?

Mr. SIMONS. I think their hope is that they will be able to preserve all of those options and they certainly intend throughout the Soviet establishment ruggedly to maintain and defend Soviet interests.

All I am saying is that if a reform program of the kind now projected, if implemented over a period of years, ought to make it more difficult for them to exercise the kind of control——

DEMOCRATIZATION PROGRAM

Senator PROXMIRE. Now you speak, incidentally, along that line—you spoke of a democratization program which you said is in its early stage, in its infancy, but I just don't see that. It's true that they are having some kind of mosquito abatement elections, but the elections are very meaningless. There's no real power in the people elected. There's no real alternative as far as any kind of significant policy is concerned. Isn't that right? And the democratization is almost invisible, isn't it?

Mr. SIMONS. Well, I think that's true up to now, but, Mr. Chairman, if I may be permitted an anecdote which comes from a Soviet source, it's not mine personally, but a recent American visitor to Moscow had a private conversation with a Soviet and they were talking precisely about democratization. The Soviet said, "I recognize that what we have entrained doesn't look very impressive by your lights or by your standards," and he said, "It is not. But I have to tell you that it is a question of political culture here. Soviets are not used to debating each other without winners and losers. They are not used to the kind of political debate which is not zero sum game and we're trying to change that."

And the example he gave was a factory in the provinces where they were having their first election for a factory manager, something which sends shivers of horror I think—would send shivers of horror down a great deal of American management if it were applied here—and doesn't raise hosannas there, either. But you had the situation where you had to get two candidates for a factory manager.

The problem was what they were going to disagree with each other on because they had no tradition of disagreement, especially in elite positions.

So one of them looked out over the landscape and looked at the fact that workers at this factory were forced to—the buses left them off in the morning 300 yards from the factory entrance and they had to slog through the snow for that distance. So he ran on the platform that he was going to change that. That was the only thing that he could think of that would differentiate himself from the manager, ran on that platform, won, and within a period of weeks he did get the buses to come up to the factory gate and save the workers those 600 yards of tramping through the snow.

Now you can say that's insignificant, but in Soviet terms, it is an evolution in the right direction. That is the only context in which I was situating this democratization.

SOVIET DEMILITARIZATION

Senator PROXMIRE. Let me ask you this. A witness who will testify later today—and incidentally, Mr. Luttwak wasn't able to give us his prepared statement in advance, but Mr. Hough and Mr. Levine were—and I warmly commend those prepared statements to you. I think that they are very, very thoughtful, most perceptive, and I think the State Department can learn a great deal from studying those prepared statements.

Professor Hough of Duke University says that the Soviet military threat has held the Western alliance together and submerged the economic conflicts, for example, between us and Japan. But if the Soviets adopt a less threatening posture militarily, the management of Western economic confcits will become much more difficult.

What's your reaction to that?

Mr. SIMONS. I think we would welcome the challenge. If the Soviets really do demilitarize themselves, it may be true that we will have to pay more attention to economic tensions and conflicts, but

I think it's something that our alliances are very much up to and it would be a challenge that we would welcome.

So far, it hasn't happened. The Soviet Union remains a highly militarized great power in world affairs. So for the time being I think we ought to concentrate on that.

STALIN AND GORBACHEV COMPARED

Senator **Proxmire**. Professor Hough believes that Gorbachev's political position at home is very strong, as strong as Stalin's in 1928–29. He points out, for example, that Gorbachev doesn't face a Congress or a Supreme Court or elections and something he doesn't point out but which I feel very strongly about has a totalitarian system where the politburo controls the whole economy.

It's not like our system where our Federal Government, altogether, with all its checks and balances, controls only one-quarter of the economy.

Nevertheless, he says that in his judgment Gorbachev's position is as strong as Stalin's in the 1928–29 period, from that period on. He says the concessions made in the INF negotiations reflect the fact that Gorbachev is politically so strong he does not have to worry as much about the domestic costs of such concessions.

Do you agree with that or disagree?

Mr. **Simons**. I think it's not a very encouraging comparison because if Gorbachev were as strong as Stalin was in 1928–29, 1928–29 were followed by what amounted to a civil war, a war of Soviet power against the Soviet peasantry, which Stalin later told Roosevelt—or Churchill, I forget which one—the losses were probably—it was as bad a crisis as World War II itself. So if Gorbachev is only that strong, that is where he's going to need a civil war to——

Senator **Proxmire**. Now wait a minute. What were the consequences of that effort on the part of Stalin?

Mr. **Simons**. Well, he finally won, but——

Senator **Proxmire**. He sure did, and as you say, it was over tremendous opposition.

Mr. **Simons**. Ten years and 30 million people.

Senator **Proxmire**. And he won very decisively, cruelly, brutally, but he won.

Mr. **Simons**. But I hope Gorbachev, if he's to win, I hope he will win with fewer casualties than the war against the peasantry and sending large sectors of the population off into prison camps.

GOAL OF ARMS CONTROL

Senator **Proxmire**. Let me ask you this. Many analysts believe that the Soviets need breathing space in order to deal with domestic economic problems. They are thus eager to enter into arms agreements and take other steps to ease international tensions.

Is that why Gorbachev wants a summit and INF agreement and perhaps a more far-reaching strategic arms agreement?

Mr. **Simons**. My feeling has been that since the late 1970's, as I mentioned earlier, the sense of systemic crisis or precrisis has been pervasive in the Soviet elite. So that they have been looking for ways to tailor their commitments, perhaps to abate some appetites, to stabilize their international situation.

So I think probably that is one motive for the approach, to the extent it is new, that they have taken under Mr. Gorbachev.

On the other hand, Mr. Chairman, any good policy—it's true in this government and I think it's also true in Moscow—any good policy usually has a variety of motives. I think the Soviet motive of dividing the Western alliance remains important. I'm not sure that they think they can save an awful lot of money from the kinds of arms control that they can realistically project out there. I think they would like to if they can, but the idea of a general breather seems to me to be misplaced.

I think the Soviet Union is going to continue to defend its core interests in world affairs pugnaciously and will spend the resources and make the policy commitments required to do that.

So even if they are watching more carefully at the cost of foreign commitments, even if they are avoiding new adventures, I don't see that as a general retreat, a general reassessment, or a general breather. I think that they are still an alert and potentially dangerous competitor for the kinds of values the United States espouses in world affairs and that that will continue.

Senator **Proxmire**. Thank you, sir.

Congressman Fish.

OUTLOOK FOR GLASNOST'

Representative **Fish**. Thank you, Mr. Chairman.

Mr. Simons, we have had 3 days of hearings on this subject prior to today and you appear to be a member of that group which has serious reservations about the success of Gorbachev's economic reforms.

I would say that the majority of the expert testimony we have runs the gamut from being pessimistic about those reform prospects to moderately optimistic.

One expert separated glasnost' from economic reforms and thought that while the reforms ran into all the obstacles we have all become familiar with, that irrespective of how those reform efforts ultimately fare, glasnost' in the social sphere will survive.

Could I have your view on that?

Mr. **Simons**. Well, I'm not sure the Soviets themselves see it that way and I'm not sure that I see it that way. Analysis of this kind has to be speculative because the system remains very secretive even under these conditions of glasnost'. So analysis will differ.

My feeling is that there has been a sequence to the reform effort in the Soviet Union as the difficulties have become more and more apparent to the leadership. My feeling was that they came into power in 1984–85 much more sanguine about the possibilities of directed reform than the situation warranted and that they are on a learning curve as to how difficult it is to move a society as conservative and as inertial as Soviet society. So that they have gone from piece to piece.

They began, as I mentioned, with these so-called human factor reforms—discipline, anticorruption, antialcoholism, application of science and technology, computers in the schools—things which really did not require restructuring. They went from there to so-called restructuring to put in place the bases for serious economic reform.

Discovering that that was going to be difficult to implement, they went to glasnost' which basically is an effort to mobilize the intelligentsia on behalf of a reform impulse and a reform effort.

Now the intelligentsia—there's prior experience with this because Khrushchev in the 1950's similarly organized the intelligentsia in favor of change and change in a direction which we would consider positive and did then. That effort ended.

So the historical precedent for glasnost' going on without economic reform succeeding is not a good one. Glasnost', the 1950's Khrushchevian variety of glasnost', ended in the 1960's. The intellectuals were put back in their box.

So I see no necessary continuation of this kind of opening outside of general advance on the reform program. I think probably functionally there are interlinkages, not all of which are easy to define, but genuine interlinkage.

U.S.-SOVIET POLICY AFTER DÉTENTE

Representative Fish. Thank you. At the beginning of your prepared statement you say: "The implications for the U.S. is that we should stay our present policy course" and later you refer to "Gorbachev will have to engage us in dialogue across the four issue areas of concern to the United States."

But what our policy is and what our major concerns are is not spelled out for me and I wonder if you could tell me what it is?

Mr. Simons. Certainly. With regard to structure, we have tried to develop a policy during this decade, an agenda for interaction with a policy toward the Soviet Union which includes all the major issues between the two countries.

This is based on the perception that the détente agenda of the 1970's was too narrow to command sustained political support in this country or to allow this country to deal with all the issues between us and the Soviets.

As you recall, it was mainly arms control and there were some economic relations and there was a little bit of respect thrown in. This proved, as I say, too narrow to sustain itself politically here because it left out large areas of conflict and interaction between us and the Soviets.

FOUR-PART AGENDA

So we have tried to put in place this four-part agenda which includes arms control indeed, but also as integral parts the problems of regional issues, so-called regional issues, tensions in third areas, and how to deal with them, which includes as a separate category or agenda area human rights, not as a bilateral issue but as a problem of international relations and of the international order that is raised in its own regard.

Finally, bilateral issues per se, which is a tremendous grab bag running from conduct of relations in embassies and travel controls and visas through economic relations to scientific and technological cooperation and people-to-people exchanges.

So we have tried to be comprehensive in the agenda that we have set forth. We have also tried to base our objectives in each area of the agenda on U.S. interests, trying to define what it is of interest to the United States in each area, and encouraging the Soviets to take those interests seriously into account.

For instance, on arms control, the President has set forth four criteria against which we operate in every area. We want reductions and we want them to be militarily significant, equitable, and verifiable—those four things.

Now they more or less fit each area of the arms control agenda, but as criteria, as objectives for things that would be to the advantage of the United States if they were attainable, that is the approach.

This allows us, we think, to explain this comprehensive agenda in American politics and to capture bipartisan support for it because the criterion is longer negotiability. The criterion is not how much we can get per se in negotiations with the Soviets, but it is how much we can get in terms of these clearly defined national interests.

Representative **Fish**. Could I interrupt——

Mr. **Simons**. That is the program we have been pursuing and, Mr. Chairman, we think——

Representative **Fish**. Well, I'm going to run out of time in a minute and I won't get into my followup question.

Mr. **Simons**. I'm sorry.

CALL FOR A BOLDER APPROACH

Representative **Fish**. I think this would lead right into it. I'm sure you know that a number of prominent U.S. observers, notably a group of 40-odd experts, released a report on this subject in the last few days and they are calling for a more straightforward, indeed bold negotiating approach to Gorbachev's initiatives.

My question is, What tangible risks would the Reagan administration run if it took Mr. Gorbachev up on his own invitations, and do you consider this statement by these observers to be a challenge to what you've just referred to as a comprehensive approach?

Mr. **Simons**. No, because I think it's actually quite a sound document, the document that this panel has produced. It is entirely consistent with the four-part agenda. If you read the details of it, it divides down into those four parts and it puts forward some suggestions and some encourgement to proceed forward, but in my view it is consistent with the approach which we already have.

It asks us to do more. So basically, I don't feel negatively challenged by that report. Indeed, I find it encouraging, given the range of opinion that was represented on that panel—encouraging support for the approach which we already have in place.

Representative **Fish**. Good. Thank you, Mr. Chairman. This is the report put out by the Institute for East-West Security Studies and I wonder if I could ask unanimous consent that it be made part of this record?

Senator **Proxmire**. By all means. It will be printed in the record in full.

Representative **Fish**. Thank you, Mr. Chairman.

[The report referred to follows:]

Special Report

How Should America Respond to Gorbachev's Challenge?

A REPORT OF THE TASK FORCE ON SOVIET NEW THINKING

Co-Chairmen

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Harvard University

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Convened under
the auspices of the
Institute for East-West
Security Studies

Institute for East-West Security Studies
New York 1987

SIGNATORIES OF THE REPORT

The Report represents a consensus of the Task Force. The group believes it to be an important contribution to the debate on Soviet policy and East-West relations. Specific policy recommendations should not, however, be attributed to individual members of the Task Force. The signatories of the Report participated in their personal capacity. Affiliations are for identification only.

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Foreword

Recent signs of important changes in Soviet thinking about its domestic and foreign affairs pose important new challenges and opportunities. Taken together with major reforms being undertaken in most other European socialist countries, these changes call for a process of policy reexamination in the West and a new dialogue between East and West on ways to create a more stable and cooperative relationship.

These changes in the East have not yet been fully responded to by the West. It is increasingly clear that they represent more than a change in style or rhetoric. What then are the implications of these changes for Western policy? How should America and its allies respond to Gorbachev's challenge?

With this in mind, the New York-based Institute for East-West Security Studies, an independent European-American public policy research center, convened a bipartisan 38-member Task Force of prominent Americans to examine the content and policy implications of the new thinking and propose policy recommendations. The Task Force members met six times over an eight-month period in Washington and New York. European officials and specialists, together with members of the U.S. Congress, participated in specific Task Force meetings.

This bipartisan American Task Force represents the first stage of a multi-year process by which the Institute for East-West Security Studies intends to engage Americans, Europeans, and Soviets in a systematic discussion of the changing relationship between East and West. The Institute regards this Task Force study as a necessary first step towards establishing a new East-West dialogue and looks forward to contributing to and broadening that dialogue. Following the work of this American Task Force, the Institute plans to initiate a second Task Force with broad European participation designed to carry the discussions further.

The Board of Directors of the Institute expresses its appreciation to the members of the Task Force, both for their dedication during the eight-month process which led to this report, as well as for their important substantive contributions. The successful conclusion of a written report with which all members of the Task Force concurred is due in great measure to the exceptional chairmanship of Joseph Nye and Whitney MacMillan, and to the skills of Institute staff members Allen Lynch and Keith Wind. Special appreciation is also paid to Robert Legvold, John Hardt, Marshall Goldman, and Richard Ullman, members of the Task Force who contributed working papers to the six sessions.

The Institute is deeply grateful to the Carnegie Corporation of New York, The Ford Foundation, George Soros, and Harold Newman for their financial support of this Task Force project. Individual members of the Task Force—Dan Rose, Steve Swid, Mike Forrestal, Guenther van Well, and Harold Newman—graciously opened up their homes for the meetings of the Task Force. Their hospitality is deeply appreciated.

Several members of the Institute staff deserve particular recognition for the success of this report, including Task Force coordinator Keith Wind, principal drafting rapporteur Dr. Allen Lynch, Director of Studies F. Stephen Larrabee, Claire Gordon, Peter B. Kaufman, and Ian Richardson. Special thanks are paid to Amy Lew, who typed the manuscript through seemingly endless revisions. Finally, I'd like to express my personal appreciation to my colleagues on the Institute Board of Directors for their foresight and commitment to making this project possible.

The members of the Task Force believe that this report is an important contribution to the East-West dialogue and are working to make its contents widely known among the policy communities in East and West. The Institute for East-West Security Studies is proud to have sponsored this study and looks forward to continuing the process which this Task Force has begun.

John Edwin Mroz
President
Institute for East-West
Security Studies
New York
October 10, 1987

Preface

The changes that Soviet leader Mikhail Gorbachev has recently launched in both domestic and foreign policy have captured world attention. On a range of key issues—from domestic economic reform to nuclear arms control to emigration—Gorbachev's leadership has revised long-standing Soviet positions and in the process challenged the United States and its allies to reexamine many of the assumptions behind their own policies toward the Soviet Union.

The following report on Soviet policies under Gorbachev and their impact on Western interests and responses represents the first concerted effort in the United States to analyze and evaluate the significance of Gorbachev's domestic and foreign policies and their implications for East-West relations. More specifically, the report proposes a series of policy recommendations and goals which respond to the new opportunities presented by the changes in the Soviet Union.

The report appears at a critical juncture in U.S.-Soviet relations, as the two superpowers are about to convene a summit and sign a treaty eliminating intermediate-range nuclear missiles. This event provides an appropriate occasion to examine the broader spectrum of U.S.-Soviet and East-West relations, and the next steps the two sides could take to enhance international stability and put their relations on a stable footing over the long term. The broad scope of the report responds to the need to address all of the sources of instability in the East-West relationship—military, political, economic, ideological—in order to construct a sounder long-term foundation for peace.

The bipartisan character of the report underlines the strong consensus reached on the need to reexamine America's Soviet policy and engage the Soviet leadership in a process aimed at a long-term and stable relaxation of tensions. We feel that the report is a noteworthy contribution to the debate now emerging in the United States over the future direction of U.S.-Soviet and

East-West relations and that the analysis and conclusions it puts forth deserve to be taken as a point of departure in that debate.

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Executive Summary

Key Findings

In the face of domestic economic stagnation, widespread social apathy, and a widening technological gap vis-à-vis the West, Soviet General Secretary Mikhail Gorbachev has undertaken the most far-reaching revamping of the Soviet system in over half a century. While the Soviet Union remains a closed communist society, Gorbachev has challenged a whole series of ingrained practices and attitudes, from strictly centralized economic management to an often militarized foreign policy, which has been the basis for Soviet policy since Stalin's time. In foreign affairs, he has introduced new concepts and new flexibility into Soviet diplomacy. Yet the West has not come to terms with these changes.

Balancing Soviet power and maintaining a strong Western alliance remain central to U.S. national interests. By the same token, the U.S. and its allies have a long-term interest in encouraging the moderation of Soviet power. Because the Soviet Union is a global power, Gorbachev's initiatives demand an active response by the United States and its Western allies. In many areas, from arms control to emigration, the Soviet Union has begun to make changes in directions long advocated by the West. While far from complete, these changes present new opportunities, and challenges, which the West should not ignore. The Task Force strongly recommends that the United States and its Western allies welcome the reformist tendencies that Gorbachev has set in motion and encourage those which promote a moderation of Soviet power. Toward that end, the U.S. and its allies should engage the Soviet Union in an effort to explore possibilities for agreement and resolve key points of tension.

A purely reactive Western approach in the face of the new Soviet policy is not an acceptable option, the Task Force believes. Western policies as well as Gorbachev's domestic policy priority are bound to affect Soviet foreign policy. There is considerable uncertainty about the long-term success of Gorbachev's reforms. Nevertheless, over time, the new course chosen by Gorbachev will affect the ways in which the Soviet Union carries out its role as a superpower. A more subtle and flexible Soviet diplomacy requires the West to develop a broader and more active policy toward the Soviet Union, including standards to define and meet common security requirements in a rapidly changing international environment. Failure to do so would sacrifice the diplomatic initiative to the Soviet Union as well as abdicate our responsibility to future generations to pursue prospects for substantially improving relations between East and West.

What is Changing in Soviet Foreign and Domestic Policy?

The West needs to think anew about specific changes the Soviet Union has made in its own policies. Many of these changes are only beginnings and ultimate Soviet intentions remain unclear, but it is important to note that some of them move toward long-standing Western preferences:

- *Arms Control* — The USSR adopted the Western proposal of a zero option on the INF issue. In addition, the USSR has moved toward the Western positions on verification, including on-site inspection. It has also raised the prospect of asymmetrical conventional force reductions in central Europe. It has accepted the principle of deep reductions in offensive strategic weapons and proposed a concept of "sufficiency" in military forces.

- *Role of the Military* — There has been a reduction in the Soviet military's role and influence in the highest policymaking councils, and Gorbachev has made clear to the military that they have to accept spending restraints and greater openness in the dissemination of military information.

- *The International Economy* — Gorbachev has placed special emphasis on reducing Soviet autarky by increasing trade, joint ventures, and expressing an interest in cooperating with such major international organizations as GATT.

- *The Domestic Economy* — Gorbachev has initiated a major decentralization of operational responsibility for the economy, and he clearly intends to move toward a more flexible, modern, and efficient economic planning and management. He has admitted the inadequacy of Soviet statistics and called for more accurate economic information.
- *Human Rights* — In the fields of culture and dissent, Gorbachev has displayed a degree of openness and toleration unthinkable just three years ago. In the area of emigration, the change has been less dramatic but Gorbachev has increased the emigration of Soviet Jews, Germans and other groups. While *glasnost'* has a long way to go, it has clearly led to progress on human rights, which has been a major concern of the West.
- *Regional Issues* — While Gorbachev has as yet made no significant effort to scale back existing Soviet global commitments, he has given a lower priority to the military expansion of Soviet interests in the Third World than his predecessors.
- *Eastern Europe* — While urging closer and more "efficient" economic integration, Gorbachev has permitted a somewhat more flexible expression of specific national interests in Eastern Europe than his predecessors.

Agenda for Action

These changes in Soviet policies and the prospect of a Soviet-American INF treaty and summit by the end of this year highlight the need to tackle a wide range of problems in East-West relations. The Task Force recommends that as first steps Western policy choices focus on five key areas:

- *Security Issues* — The U.S. and its NATO allies should intensify talks with the Warsaw Pact aimed at reducing conventional forces and eliminating offensive strike potentials, particularly those designed for surprise attack. Given the geographical differences and existing force imbalances, new approaches must include asymmetrical reductions of forward-based armored units, which present the greatest threat of surprise attack.

Both sides need to move rapidly to conclude an agreement on deep cuts in strategic offensive nuclear forces. These reductions should be designed to enhance strategic stability and eliminate the capacity to launch a crippling first strike. At the same time, both sides need to find ways to strengthen the ABM Treaty and to ensure that any research on strategic defensive systems is consistent with preservation of the Treaty.

The West should push for a rapid conclusion of the global Geneva chemical weapons negotiations, including the establishment of an international verification regime. Such an agreement would help increase confidence in Europe at a time when some are concerned over the implications of the elimination of medium- and shorter-range nuclear missiles from the continent.

- *International Economic Issues* — Except in a precisely defined area of strategic technologies, which entails tighter, more efficient COCOM regulations, expanded East-West trade is in our interest. The West should welcome Soviet efforts to develop the legal foundation for a system of equitable joint ventures. While Western governments should not subsidize credits, neither should they oppose the extension of private credit through normal commercial rates and practices to the Soviet Union. The prospect of observer status in the GATT and IMF should be used to encourage greater openness and information about the Soviet economy.

  If the Soviet Union demonstrates heightened respect for human rights, the U.S. government and Congress should consider bringing their policy in congruence with U.S. allies by reevaluating the Jackson-Vanik and Stevenson amendments restricting trade with and credit to the USSR. The West should aim to normalize the framework for trade with all Warsaw Treaty countries, on the basis of mutual and reciprocal interests.

  In addition, the U.S.-Soviet umbrella agreements on scientific and technological cooperation should be revived and expanded, on the basis of full reciprocity.

- *Human Rights* — The West should welcome increased *glasnost'* while continuing to make clear to the Soviet government that its observance of internationally recognized human rights is the mark of a civilized power and a condition for truly collaborative relations between the Soviet Union and the West. The West should insist that the Soviet Union fully live up to the commitments it undertook under the Helsinki Final Act to encourage the free movement of people, ideas, and information across international boundaries.

- *Regional Issues* — In Afghanistan, the West must continue to make clear that Soviet occupation of that country poses strict limits to genuine collaboration between the USSR and the West. Conversely, a rapid Soviet withdrawal, with sufficient international guarantees, would be a forceful demonstration that the "new political thinking" has specific policy implications.

  In other areas of conflict which could lead to possible superpower confrontation—such as Central America, southern Africa, and the Persian Gulf—the West should intensify discussions aimed at clarifying interests and creating conditions for greater stability. Within this framework, U.S.-Soviet meetings on regional issues should be upgraded as part of a regularized summit process. The purpose would be to seek solutions to these problems in conjunction with other concerned parties.

  In the Arab-Israeli dispute, the U.S. and USSR should work together to advance a peace process which guarantees the territorial integrity and interests of all states and parties.

- *Political Dialogue* — U.S.-Soviet summit meetings, as well as meetings at other governmental and non-governmental levels, should be held on a regular basis.

Conclusion

The West must have no illusions about the need to balance Soviet power, but neither should it overlook opportunities to encourage the Soviet Union to be a more responsible and integrated member of the international community. Although the long-term success of Gorbachev's policy remains uncertain, the process he has launched holds out a promise of a further moderation of Soviet power and an opportunity to develop and institutionalize areas of cooperation in the East-West relationship.

Some in the West worry about giving the Soviet Union a "breathing spell." They fear that Gorbachev's economic reforms will simply strengthen the USSR in the long run. But Soviet economic and social problems will not be quickly solved. In the meantime, greater openness and pluralization should be welcomed for their own sake as well as for the effect they can have in moderating the way Soviet power is used.

In order to seize the opportunities offered by new Soviet policies, the U.S. and its allies need to respond creatively to Gorbachev's initiatives. In order to do that, the West must be clear about its own policy objectives and priorities. New political thinking in the East requires new policy thinking in the West.

Report of the Task Force

I. Introduction: Gorbachev's Policy Is Different

After two and a half years in power, Soviet leader Mikhail S. Gorbachev has made it clear to both domestic and foreign audiences that he intends to carry out a thorough restructuring of the Soviet system in an effort to make the Soviet economy capable of effectively assimilating the opportunities offered by contemporary science, technology, and methods of management. Concerned that the Soviet system inherited from the Brezhnev period had become ossified, with consequences for the USSR's international standing as well as its material well-being, the new Soviet leadership has called into question a whole series of institutional arrangements and attitudes—ranging from a strictly centralized economic management system to an often militarized foreign policy—that has provided the foundation for Soviet policy for nearly sixty years. Not content with the kind of administrative adjustments that ever since Khrushchev's time have been the Soviet substitute for meaningful reform, Gorbachev has repeatedly underscored the need for structural economic reform and, just as important, for social and political reforms in order to sustain the economy over the long run.

The sheer magnitude of change that is currently being attempted in a country of the size and international import of the USSR would of itself demand the world's attention. The interest of the international community is further engaged by the emphasis the Gorbachev leadership has placed on aligning Soviet foreign policy more closely with long-term internal requirements, particularly the modernization of the economy. This has entailed an evident rethinking in Soviet policy circles about the requirements of foreign and security policy in an age characterized by mutual nuclear deterrence and global interdependence.

II. Foreign Policy Trends Under Gorbachev

When Gorbachev became General Secretary in March 1985, many Western observers assumed that, due to the pressing nature of domestic affairs—especially in the economy—Soviet foreign policy would show little innovation at first. Yet Gorbachev's actions and statements, particularly since the 27th Party Congress in February/March 1986, suggest that his foreign policy perspective differs significantly from that of his predecessors. While change is currently often more noticeable on the conceptual than the policy level, the new Soviet leadership seems to recognize that serious economic and technological deficiencies jeopardize the USSR's international position, and that reversing these trends requires not only major economic modernization but also many new foreign policy approaches.

It is important when considering the foreign policy implications of Gorbachev's initiatives and statements not to focus unduly on the concept of "new thinking" as such, which has been advanced by Gorbachev and his associates as a general rubric for the General Secretary's approach to international affairs. Any "new thinking" takes place within a historical context of adaptation by the Soviet leadership to external realities. It is this broader pattern, and not any particular slogan, that should be the focus of Western attention.

In many ways, the world view that Gorbachev and his colleagues have been formulating represents an explicit crystallization of tendencies that have been present—often in piecemeal form—in Soviet policy circles since Nikita Khrushchev's anti-Stalin speech at the 20th Party Congress in 1956. But the resultant synthesis of new and traditional elements constitutes a distinctly "Gorbachevian" perspective which seeks to integrate domestic and foreign policy in a mutually reinforcing combination.

First, the Soviet leadership has concluded that the USSR's international relationships should be subordinated to the prime task of economic modernization at home. Gorbachev's desire for domestic reform has led him to search for structures of stability in critical areas—in arms control, most visibly—which would provide a durable and predictable framework for the resource choices that must be made in the coming decade and beyond. The need for such stability assumes double importance for Gorbachev since instability in the USSR's foreign relations could affect not only the politics of resource allocation but the viability of Gorbachev's own political position.

Second, the Gorbachev leadership has concluded that a favorable international environment can only be created on the basis of a *political* accommodation with the leading industrial powers, and above all with the United States, which remains the focal point of Soviet attention in foreign affairs. The Soviet choice for accommodation thus represents more than a "tactical" adjustment to shifting circumstances, the "breathing spell" that some in the West have detected. Rather, it reflects a strategic reevaluation of the international environment and of the international factors affecting the USSR's global position.

Third, there has been a major reexamination of security issues. Top Soviet officials, including the Soviet military, stress that a nuclear war cannot under any circumstances be won. As a corollary the leadership now argues, with implicit criticism of Soviet security policy under Brezhnev, that security cannot be obtained through military means alone. Security in the nuclear age is said to be mutual in character and, due to the destructive potential of modern weaponry, a common concern of all countries. Relatedly, Soviet policy analysts and Gorbachev himself claim to reject nuclear weapons as a durable guarantor of peace. They assert that even nuclear parity, which they continue to regard as a major historical achievement of socialism, could cease to be capable of ensuring stability in the face of an unregulated arms competition between East and West. Nuclear arms control thus assumes priority as a means of reducing the external threat, limiting resource requirements for the military, and establishing a framework of stability in East-West strategic relations, although the effect on Soviet arms programs and deployments is still unclear.

Fourth, the Soviet concept of peaceful coexistence is being revised. Key Soviet policy analysts now interpret peaceful coexistence less as a form of class struggle—the traditional Soviet viewpoint—and more as a long-lasting condition in which states with different social and political systems will have to learn how to live with each other for the indefinite future. As Yevgeny Primakov, a close advisor to Gorbachev, recently noted in a key article in Pravda, peaceful coexistence is no longer regarded "as a breathing space" by the Soviets. "Interstate relations," he emphasized, "cannot be the sphere in which the outcome of the confrontation between world socialism and world capitalism is settled."* Such coexistence is said to imply not the simple absence of war but instead an international order in which not only military strength but relations of confidence and cooperation prevail, and "global problems"—the arms race, ecological problems, Third World development—can be resolved on a collaborative basis.

Finally, the Gorbachev leadership evidences increasing recognition of the multipolar and interdependent character of contemporary international relations. This view is reflected in a growing tendency on the part of the USSR to deal directly with key regional actors, such as China and Japan in the Far East, Egypt and Israel in the Middle East, and Mexico in Central America. The main goal has been to reduce the USSR's diplomatic isolation, which was increasingly evident in the late Brezhnev era, and to multiply Soviet options. If this process continues, the West can expect increasingly sophisticated and pragmatic Soviet policies throughout the world.

Of course, rhetoric and policy are two different things, and the world will have to wait to see just how far shifts in attitude and doctrine will be reflected in practice. It is thus difficult to gauge precisely how the "new thinking" has affected foreign policy. Yet, significantly, changes in Soviet policy in specific areas—agreement to the U.S. proposal of the zero option, rejected by the Brezhnev/Andropov leadership, on the INF issue; and interest in participation in GATT and the IMF as well as key Asian/Pacific economic organizations—does suggest deeper changes that are more than a response to tactical opportunities.

Most significant, recent changes in Soviet statements on European conventional arms issues, especially a stated willingness to accept asymmetrical reductions in conventional forces and a restructuring of forces and operational doctrines so as to eliminate offensive capabilities, open possibilities for meaningful conventional arms negotiation which could enhance East-West security. How far these changes will go remains unclear. Gorbachev and his associates seem to have realized that the USSR cannot achieve its desired world of radical nuclear reductions without changes in its own conventional force posture as well. As yet, these changes have been largely rhetorical. However, given the special legitimizing function of political

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**Pravda,* July 9, 1987, p. 4.

rhetoric in communist systems, such changes should not be dismissed out of hand.

Clearly, an important motivation behind the new Soviet policies is to strengthen the USSR as an international presence over the long term. Some Western observers have thus wondered whether the West would not be more threatened by the success of Gorbachev's policies than by their failure. Such an interpretation misreads the stakes that are involved in Gorbachev's course of reform. First, Gorbachev has admitted that his comprehensive reform will not be achieved overnight; rather, it is a process seen as spanning decades. Second, to the extent that it is within Soviet capacity—which remains considerable—no politically significant sector in the USSR will permit a weakening of Soviet power. The issue for the West really involves the question, *what kind* of USSR does it wish to see emerge from the process of internal revitalization and *how* will it use the power at its disposal? The reform course that Gorbachev has chosen, by encouraging the formation and institutionalization of interests and social sectors long underrepresented in Soviet policy-making, could over time affect the way in which the USSR relates to the outside world. Clearly, Gorbachev has no intention of significantly relaxing the Communist Party's monopoly of power and its control over the Soviet public agenda. Yet, if the ways in which power is exercised are modified so as to multiply those voices within the Soviet system who have an objective interest in cooperative relationships with the outside world, it could well change the way the Soviet Union conducts its foreign affairs.

While the motivating factors behind the Soviet reform process are overwhelmingly domestic in character, they open new, albeit limited possibilities for constructive Western policies to advance the common interest in a more stable, cooperative, and mutually beneficial international order. The way that Gorbachev has launched the reform process, by stressing the tight linkage between internal and foreign policy and by a series of doctrinal statements and policy initiatives aimed at intensifying the USSR's ties with the international community, opens new opportunities for more thoughtful, creative Western policy toward the USSR.

III. Domestic Policy Under Gorbachev

Gorbachev's primary goal is to revitalize a stagnant Soviet system from within. This requires a restructuring of the Soviet economy to improve economic productivity and more effectively assimilate contemporary technological developments into the daily Soviet economy. In the 1970s the Soviet economy maintained average growth rates of 4-5 percent per year, while in the 1980s that figure dropped to 1-2 percent. Gorbachev has shown himself intensely aware of the *relative* economic/technological backwardness of the USSR compared to such key rivals as the United States, Western Europe, and Japan. He is far less satisfied than previous Soviet leaders with enumerating past Soviet accomplishments and is determined to force the Soviet economy to confront demanding international standards. Gorbachev believes that the USSR's ability to maintain its international position will depend on its economic performance at home and that the USSR "has no choice" but to enter on the path of radical reform, as he put it to the January 1987 meeting of the Communist Party's Central Committee.

Gorbachev's basic choice for structural reform has raised fundamental issues of strategy and means. Most important, perhaps, Gorbachev's economic program implies a serious restructuring of Soviet resource allocation. The choices involved are not simply limited to tradeoffs between military expenditures and consumption, as is often assumed in the West, but includes those among military expenditure, consumption, *and* the civilian economic investment essential to the long-term soundness of the Soviet economy, and, by extension, the power base of the USSR's international position. That Gorbachev is acutely aware of these tradeoffs is shown by his application of *perestroika*, or restructuring, to the military, which has had to accept constraints on military spending. Indeed, the adoption of the concept of "reasonable sufficiency" by the new Soviet leadership—which remains to be defined in operational terms—appears to reflect an effort to limit demands upon scarce resources and an understanding of the limits to the military and political utility of armed force in general and nuclear weapons in particular. Under these circumstances a general relaxation of international tensions, with a corresponding relaxation of military demands upon scarce resources, is central to the viability of Gorbachev's program.

The key elements of Gorbachev's domestic reform include a combination of economic, social, and political measures. In the economic field, the focus is on:

(1) *Structural Reorganization* — Under Gorbachev's strategy, the system of planning will shift toward strategic centralization, with less detailed and more indicative-type planning coming from the central agencies. More control over general planning and strategy will be held by the responsible political leaders at the top, while responsibility for day-to-day management decision-making will be decentralized to the local level, to the farms and factories, operating under a market-simulating mechanism in which the enterprise is expected to perform as a self-financing, self-managing center. Prototypes of this institutional restructuring are found in the fields of agriculture and foreign trade, with the establishment of the State Agro-Industrial Commission, which combines the functions of several agricultural ministries, and the State Commission for Foreign Economic Contacts, which supersedes many of the functions of the Foreign Trade Ministry. Inherent in Gorbachev's approach is the assumption that central planning of the framework of development is both compatible with, and a precondition for, the development of market forces at the decentralized management level of farms and factories, as it assures bureaucratic acceptance of local self-management, self-financing, and autonomy.

(2) *Improved Productivity* — Gorbachev understands better than any previous Soviet leader that the Soviet economy has reached a basic impasse in its development: sufficient growth can no longer be assured through the simple expansion of increasingly scarce resources such as land, labor, and capital but rather must take place on the basis of dramatically improved productivity of available resources. There will, for example, be a labor shortage of nearly 19 million workers during the current five-year plan. Gorbachev thus wants to create a more efficient economy that will use material and human resources better and will generate output that approaches the world level of quality. This strategy appears to take as its model the transformation of the postwar Western industrial economies, in which efficient technological systems were introduced to significantly increase the productivity of energy, agricultural resources, manpower, and other inputs to production. The Gorbachev leadership in general has made clear the rationale for replacing a system based on extensive

but wasteful production with processes that display greater efficiency and quality. As Gorbachev noted in his 1986 Party Congress speech: "A national economy which possesses enormous resources has run up against a shortage of them." Nevertheless, the process is not without risks: the wager upon human capital can be won only in the long run, while the prospect of a drop in the standard of living in the short run adds to the social pressures facing Gorbachev. How the economic reform unfolds thus bears close observation.

(3) *A Soviet Technological-Information Revolution* — Computer applications, microelectronics, the use of lasers and robotics are all part of the dramatic change occurring in the economies of the Western industrial nations. Gorbachev has repeatedly stressed that the USSR must not fall further behind in this new frontier of science, technology, and economic development. Given the serious shortcomings of the Soviet economy in this area, the central challenge of the U.S. Strategic Defense Initiative (SDI) may be in its technological message. Civilian technological dynamism drives U.S. SDI research programs and, whether or not the military defense vision of SDI is credible or attainable, many of its technological components are. Thus, SDI symbolizes a further, potentially serious erosion of Soviet claims to being an economic superpower, and because of its uneven economic base, the USSR may become a more technologically inferior military power. The Gorbachev leadership is thus determined to dramatically raise the technological level of key economic sectors, which will at the same time raise the dilemma facing the West as it decides upon the scope of technological transfer to its competitor in the East. However, the climate needed for scientific inquiry, communication, and rapid technological progress is antithetical to one in which a closed, controlled state influences key developments in the scientific sector. The unleashing of Soviet scientific capability and the full utilization of Soviet technical talents requires a more open, equitable system. The release of Andrei Sakharov and the relaxation on internal discussion *(glasnost')* may represent first steps in that direction.

(4) *A More Open and Interdependent Foreign Economic Sector* — If the Soviet economy is to make progress in this new technological revolution, it must at least selectively join the world market. Thus Gorbachev has called for controlled interdependence with the West (as well as closer economic integration with the USSR's East European allies). Reform of Soviet foreign

economic institutions is aimed at promoting direct contact and cooperation between Soviet enterprises and those of their trading partners in Eastern Europe and the West. Soviet officials have identified Western machinery imports as playing a significant role in the planned technical progress of the Soviet economy. Soviet foreign trade bodies have already been reorganized to provide greater flexibility in trade relations and a framework for joint ventures. Finally, the financing of imports will require a shift in priority toward export orientation and acceptance of increased dependence on foreign imports. If this process advances far enough, the export sector may come to challenge the military-industrial complex for priority in resource allocation.

Gorbachev's economic strategy thus requires a thorough overhaul of the Stalinist economic structure that has prevailed in the USSR since 1929. Certainly, the purely economic difficulties and dislocations associated with such a task—unemployment, plant closings, elimination of subsidized pricing of basic goods—will be daunting. What is more, the economic reform that Gorbachev has proposed necessarily entails important social and political reforms as well, since powerful vested interests as well as deep social inertia remain with a stake in the existing system. Gorbachev's program is thus truly comprehensive. Its success will depend not only on the logic of economic plans but on Gorbachev's skill as a politician to convince the Soviet people that they have a future that is worth possible short-term sacrifices, or at least changes.

It is with this awareness that Gorbachev has advanced the twin concepts of "democratization" and *glasnost'*. "Democratization," in the specific sense used by Gorbachev, should not be confused with the Western meaning of the term but rather be seen as serving two closely related functions: as a means of purging those in the party leadership and bureaucracy resistant to Gorbachev's program (by forcing them to compete with party candidates more sympathetic to Gorbachev's vision); and as a way over the longer term to make party officials more accountable to the party and local constituencies they represent (e.g., by increasing the role of the local soviets, or government councils).

This appears to be the meaning of the electoral reform recently initiated in the USSR: while elections would remain open only to party-approved candidates, the relative decentralization of political accountability implied by multiple candidates for select offices would mean a party leadership that is more responsive to local influences. As both spur and complement to the decentralization of economic management, Gorbachev's "democratization" could result in a more flexible political system, at least as far as domestic policy is concerned.

The policy of *glasnost'*, or greater openness of public discussion, espoused by Gorbachev is aimed at influencing the attitude of Soviet society as a whole (and not simply the political-governmental leadership). Whereas "democratization" seems designed as a complement to the political and personnel changes Gorbachev requires to introduce his programs, *glasnost'*, while encouraging criticism of those in the bureaucracy opposed to Gorbachev's policies, is also aimed at eliciting the voluntary collaboration of society—especially the intelligentsia—in Gorbachev's restructuring of the Soviet system. While there remain definite limits to the debate about the course of Soviet society—especially when it touches upon foreign and defense policy—the intention to shake up rigid hierarchies and promote more independence of thought appears real, with consequences (such as the current anti-Stalin discussion) that perhaps Gorbachev himself may not be able to contain. In any event, Gorbachev appears willing to risk a certain loosening of the reins as the price for both discrediting counterproductive practices and attracting the "white collar" intelligentsia—who are essential to his technology-intensive, creativity-oriented cause—to his side. In this sense, *glasnost'* represents a component part of Gorbachev's broader policy and not a short-term expedient aimed at domestic or foreign audiences.

IV. Western Interests and Policy Responses

The Task Force's review of Soviet domestic and foreign policy under the Gorbachev leadership leads to the conclusion that the Western powers should welcome and encourage the reformist inclinations initiated by Gorbachev, which hold out the promise of moderating Soviet power. Taking into account the largely internal determinants of Soviet domestic policy, the West should take advantage of the possibilities of encouraging those elements in Soviet policy that best advance Western interests. The importance of a united, consistent Western policy is underscored by the series of recent changes in Soviet policy, all of which correspond to long-standing Western preferences. To recapitulate:

1. *Arms Control* — The USSR adopted the Western proposal of a zero option on the INF issue. In addition, the USSR has moved toward the Western positions on verification, including on-site inspection. It has also raised the prospect of asymmetrical reductions in conventional forces in Europe. It accepted the principle of deep reductions in offensive strategic weapons and proposed the concept of "sufficiency" in military forces.

2. *Role of the Military* — There has been a reduction in the Soviet military's role and influence in the highest policy-making councils, and Gorbachev has made clear to the military that they have to accept spending restraints and greater openness in the dissemination of military information.

3. *The International Economy* — Gorbachev has placed special emphasis on reducing Soviet autarky by increasing trade, joint ventures, and expressing an interest in cooperating with such major international economic organizations as GATT.

4. *The Domestic Economy* — Gorbachev has initiated a major decentralization of operational responsibility for the economy and clearly intends to move toward a more flexible, modern, and efficient economic planning and implementation. He has admitted the inadequacy of Soviet statistics and called for more accurate economic information.

5. *Human Rights* — In the fields of culture and dissent, Gorbachev has displayed a degree of openness and toleration unthinkable just three years ago. In the area of emigration, the change has been less dramatic but Gorbachev has increased the emigration rates of Soviet Jews, Germans and other groups. While *glasnost'* has a long way to go, it has clearly led to progress on human rights, which has been a major concern of the West.
6. *Regional Issues* — While Gorbachev has as yet made no significant effort to scale back existing Soviet global commitments, he has given a lower priority to the military expansion of Soviet interests in the Third World than his predecessors.
7. *Eastern Europe* — While urging closer and more "efficient" economic integration, Gorbachev has permitted a somewhat more flexible expression of specific national interests in Eastern Europe than his predecessors.

If the West desires to encourage these tendencies, and to take advantage of the opportunity they offer for a durable relaxation of tensions in East-West relations, it must begin to formulate a more creative policy toward the Soviet Union. The explicit recognition of interdependence by the Soviet leadership and the effort to subordinate foreign to domestic policy provides an opportunity to develop a system of Soviet-Western relations based on competitive but not militarized interstate relations.

Toward this end, the Western powers should intensify consultations among themselves regarding future policy toward the USSR. Until there is a Western consensus about policy objectives, priorities, and the tradeoffs among them, no course of action can be effective over the long term. Western efforts should be geared to testing Soviet readiness to resolve points of tension in the East-West relationship, thereby addressing Western geopolitical concerns and affording the USSR the international stability and reduced military expenditures that a program of genuine domestic reform requires. The focus of these efforts should be on constraining the use of armed force as a means of change. Exacting standards for restraint in international conduct, as well as strict measures of verifying and enforcing compliance, would have to be developed. Yet, if a framework of understanding could be reached in this critical area, whole new areas for long-term East-West collaboration would emerge.

An agenda for action, which could provide the basis for an effective Western consensus, would include the following:

Security Issues — The prospect of a U.S.-Soviet agreement on eliminating intermediate-range nuclear missiles (INF) by the end of this year represents an important achievement in nuclear arms control and symbolizes a hopeful change in the tenor of East-West relations. Progress has proved possible due to the missiles' secondary military significance and a radical reevaluation of the Soviet negotiating position. If an INF treaty is to translate into durable progress on the core security issues facing East and West, however, both Moscow and the West need to act upon the central fact emerging from the INF discussion: that nuclear and conventional force issues cannot be treated in isolation from one another. A series of recent signals from Moscow and other Warsaw Treaty countries indicates a willingness to explore asymmetrical reductions in conventional forces based in Europe and, just as important, to enter into discussions with the Western powers about ways of reducing the offensive potential of forces based in Europe. The Soviet leadership appears to have come to the conclusion that it cannot secure a further diminution in NATO's nuclear presence on the continent without at the same time addressing the issue of its own conventional posture and operational doctrine.

There is every reason, therefore, for the West to test Gorbachev and initiate alliance-to-alliance talks aimed at developing criteria for putting such concepts into practice. At the same time, the Western powers need to face two central issues: (1) How much do they in fact desire—given the possible geopolitical consequences—conventional arms reductions that would witness a significant reduction in the numbers, and change in the nature, of Soviet (and necessarily U.S.) forces in Europe? (2) What is the West itself prepared to trade off in order to achieve such reductions? Difficult tradeoffs will be necessary if progress is to be made on this central issue of East-West security. While other issues remain on the agenda, especially those involving strategic nuclear arms control, Soviet willingness to reexamine the character of its conventional commitment in central Europe would constitute a watershed in the East-West confrontation, affecting the justification for the Western nuclear posture. Toward this end, military staffs and political directorates in the key Western capitals should begin planning realistic security options for a post-INF Europe. This includes both arms control proposals adapted to the changing circumstances and more effective, non-threatening defensive postures and missions for the remaining conventional forces. Absent that, the West will once again find itself—as in the recent INF debate—on the defensive in the face of imaginative Soviet arms control initiatives and incapable of rendering creative responses and initiatives on its own. Thus:

- The U.S. and its NATO allies should intensify talks with the Warsaw Pact aimed at reducing conventional forces and eliminating offensive strike potentials, particularly those designed for a surprise attack. Given the geographical differences and existing force imbalances, new approaches must include asymmetrical reductions of forward-based armored units, which present the greatest threat of surprise attack.

- Both sides need to move rapidly to conclude an agreement on deep cuts in strategic offensive nuclear forces. These reductions should be designed to enhance strategic stability and eliminate the capacity to launch a crippling first strike. At the same time, they need to find ways to strengthen the ABM Treaty and to ensure that any research on strategic defensive systems is consistent with preservation of the Treaty.

- The West should push for a rapid conclusion of the global Geneva chemical weapons negotiations, including the establishment of an international verification regime. Such an agreement would lead to increased confidence in Europe at a time when some are concerned over the elimination of medium- and shorter-range nuclear missiles from the continent.

International Economic Policy — The sweeping economic reform undertaken by the Gorbachev leadership offers important new opportunities for East-West economic cooperation. The greater autonomy being given to certain enterprises involved in foreign trade, the increasing emphasis on joint ventures, and the interest that has been expressed in greater Soviet involvement with such international economic institutions as the General Agreement on Tariffs and Trade (GATT), all raise the possibility of a qualitatively new level of East-West economic contacts.

As the West reviews its economic relationships with the USSR, the overriding standard for its policies should be the ways in which economic ties with the USSR affect the Soviet role in the international community. Certainly, there is broad scope—except in a precisely defined area of strategic technologies, which entails tighter, more efficient COCOM regulations—for free exchange of goods and services between Moscow and the West, and deals which reflect the true cost of the items exchanged should be encouraged. It is thus a mistake for Western governments to prevent the USSR from receiving private credits at commercial rates. An expansion of Soviet economic contacts on the global market would heighten incentives within the USSR to compete abroad and thus increase pressure on the choice of resource allocation within the country. The same holds true for any realistic joint venture policy, which will have to meet rigorous market requirements if it is to succeed: relevant prices (to avoid dumping charges), adequate repatriation of capital, and opening up the Soviet market to joint venture products. Such a policy, based upon expanding Soviet-Western trade on the basis of market value, would tend to complicate Soviet decision-making on both resource allocation and policy toward the West and introduce factors for restraint into the Soviet policy process.

Consequently, the Task Force recommends that:

- Western governments, in collaboration with the private sector, should welcome the Soviet effort to develop the legal foundation for a system of equitable joint ventures. Key sectors for such collaboration include: energy equipment, machinery, transport, communications, agricultural technology, and financial services.
- While Western governments should not subsidize credits, neither should they oppose the extension of private credit at commercial rates.
- Provided that Moscow demonstrates that operational decentralization of the economy is genuine—so that prices reflect approximate opportunity costs—and that *glasnost'* is extended to the international economic sphere by supplying detailed and reliable information relating to markets and

production, the West should give consideration to granting the USSR observer status in GATT and possibly in the International Monetary Fund.

- If the Soviet Union demonstrates heightened respect for human rights, the U.S. government and Congress should consider bringing their policy in congruence with U.S. allies by reevaluating the Jackson-Vanik and Stevenson amendments restricting trade with and credit to the USSR. The West should aim to normalize the framework for trade with all Warsaw Treaty countries, on the basis of mutual and reciprocal interests.
- The U.S.-Soviet umbrella agreements on scientific and technological cooperation should be revived and expanded, possibly in connection with the next summit meeting, on the basis of full reciprocity.

Human Rights — Western governments and private citizens should welcome increased *glasnost'* while continuing to insist to the Soviet leadership that its observance of internationally recognized human rights is the mark of a civilized power and a condition for truly collaborative relations between the Soviet Union and the West. The West should insist that the Soviet Union fully live up to the commitments it undertook under the Helsinki Final Act to encourage the free movement of people, ideas, and information across international boundaries. Moreover, it is simply a fact of political life that progressive improvement in Soviet treatment of its own citizens would also make it easier for the U.S. government to press for most-favored-nation trading status for the USSR.

Regional Issues — A key test of Soviet willingness to align its international policy with its long-term domestic requirements will be its readiness to cooperate with the international community in resolving points of tension in areas of regional instability. Two kinds of situations should be addressed: (1) the special case of Afghanistan, where the USSR has directly invaded a sovereign state, and (2) areas where regional conflicts, compounded by the tensions between levels of economic and social development, on the one hand, and insufficient political institutions, on the other, threaten to spill over into great-power confrontation, as in the Middle East, Central America, and southern Africa.

A rapid Soviet withdrawal from Afghanistan is an important litmus test of Soviet desire for international stability. To the extent that the Gorbachev leadership keeps that country under Soviet occupation, its actions will belie its words to the effect that the USSR is committed to peaceful coexistence among states, regardless of social or political system. Certainly, the West, in cooperation with the international community and the United Nations, should make every effort to provide international guarantees that Afghan territory not be used to the detriment of Soviet security interests. At the same time, the Soviet leadership needs to recognize, in accordance with its assumed international obligations, that the Afghan people have the right to establish a government of their choice, irrespective of Soviet preference.

- The West must make clear to the Soviet leadership that continued Soviet occupation of Afghanistan poses strict limits to genuine collaboration between the USSR and the West, and that, conversely, a rapid Soviet withdrawal would be a forceful demonstration that the "new political thinking" has specific policy implications.

In other regions, such as the Middle East, where the superpowers are less directly engaged but the possibility of a local conflict exploding into a great-power confrontation remains imminent, the USSR and the concerned Western powers should begin exploring practical arrangements to defuse tensions and provide for stability. This effort must proceed from the recognition that, in the Arab-Israeli dispute, for example, where the two superpowers' interests are deeply rooted in geography and political commitment, there can be no effective peace that excludes one or the other. In that region, the Gorbachev leadership has launched a series of initiatives aimed at shoring up Soviet influence throughout the area—most notably by restoring the political dialogue with Israel—and putting the USSR potentially in the position to act positively toward a peace settlement.

- In areas of conflict which could lead to possible superpower confrontation—such as Central America, southern Africa, and the Persian Gulf—the West should intensify discussions aimed at clarifying interests and creating conditions of greater stability. The existing framework of periodic U.S.-

Soviet meetings on regional issues should be upgraded as part of a regularized summit process. The purpose would be to go beyond an exposition of each side's positions to the discussion of possible solutions to these problems.

- In the Arab-Israeli dispute, the Task Force recommends that the United States and the Soviet Union work together to advance a peace process which guarantees the territorial integrity and interests of all states and parties.

Substantive Political Dialogue — Moscow and the West need jointly to explore the kind of international order each seeks in the decades ahead. It is vital that the mistakes of the early 1970s, in which each side put forth conflicting concepts of detente under the same rubric, not be repeated. Consequently, both sides need to initiate high-level political talks on an ongoing basis to explore the operational compatibility between the Soviet doctrine of peaceful coexistence—traditionally seen by the USSR as a form of the class struggle—and the Western concept of detente, which seeks to normalize governmental relations while quarantining the ideological dispute between East and West from international relationships.

- The Task Force thus recommends that U.S.-Soviet summit meetings, as well as meetings at other governmental and non-governmental levels, be held on a regular basis.

V. Conclusion

The Gorbachev leadership has defined a clear agenda in domestic policy and intends to harness its foreign policy to serve that end. In all of its policy decisions, therefore, the West needs to be clear about its goals, priorities, and the tradeoffs among them. Indeed, that is a *sine qua non* if Western policy is to be effective and constructive in the face of Gorbachev's "new thinking" in foreign affairs. The West no longer has the luxury of inaction, which it appeared to enjoy during the waning Brezhnev years and the rapid series of Soviet successions.

The West should thus not be indifferent or merely reactive to Gorbachev's policies. *First,* such an attitude would put the West perpetually on the defensive, leaving Gorbachev to define the policy agenda himself. The disarray caused by Soviet acceptance of the Western position on the zero option on the INF issue underscores the need for the West to reexamine long-held positions and define a policy agenda more in accordance with its own definition of interests.

Second, a "wait and see" attitude by the West would consciously forfeit opportunities to encourage Soviet adaptation to international conditions. *Finally,* a Western failure to respond creatively to the opportunities offered by the new directions in Soviet policy would indicate indifference as to the fate of Gorbachev's policy, which is considerably more outward-looking and interested in collaborative international relationships than any in the recent Soviet past. Western policy choices as well as Gorbachev's domestic policy priority are bound to affect Soviet foreign policy. Domestic economic reform requires a stable international environment. The West should explore every possibility—consistent with its own interests—to engage the Soviet leadership in the effort to improve East-West relations, and to make clear to the USSR the requirements of being a constructive international partner.

Viewed historically, current Soviet attitudes toward foreign affairs, which suggest a more realistic Soviet adaptation to the international environment, may be interpreted as confirmation of a patient Western policy combining military strength and political flexibility. Ironically, many of the contemporary Soviet statements on "mutual security" and "interdependence" echo prevailing Western views of the early 1970s. In response to a series of aggressive projections of political-military power by the USSR in the mid- to late-1970s, culminating in the invasion of Afghanistan, the West, and especially the U.S., quickly shed this rhetoric, downplaying arms control and collaborative security approaches. In certain ways, the West remains transfixed by the image of Soviet power that developed during the late 1970s, while the Soviets themselves are adopting approaches comparable to those widespread in the West in the early 1970s. To break this cycle, both must adapt creatively to the break that the Gorbachev leadership is making with important aspects of the Soviet past. The West can test the seriousness of Soviet initiatives by encouraging the USSR to continue developing negotiable proposals and practical approaches to issues of common security. The West must also be prepared to consider the practical consequences of its own policies, and to advance more creative initiatives. For that to happen, and yield results, there will have to be new political thinking in both East and West.

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Senator **Proxmire**. Congressman Solarz.

Representative **Solarz**. Thank you very much, Mr. Chairman. This is the first opportunity I have had to let you know what a pleasure and privilege it's been to serve with you in Congress. I refer, of course, to your recent announcement that you won't be seeking another term. I really think you have been an inspiration to millions of Americans. Having had the opportunity to work closely with you on a number of issues I know what an enormously constructive, creative contribution you have made in the deliberations of this body and now having a chance to work with you on the JEC, I see further evidence of your good work and efforts.

Senator **Proxmire**. Well, thank you so much, Congressman Solarz, for those very wise words. [Laughter.] Very nice.

COMPARISON WITH OTHER COMMUNIST REFORMS

Representative **Solarz**. Mr. Simons, I'm interested in getting a sense of how new the new economic mechanism really is and I wonder if you could spell out for us the differences between the kind of economic restructuring Gorbachev has called for in the Soviet Union and the degree and kinds of economic reform that have already taken place in other Communist countries like China, Hungary, and Yugoslavia, with specific reference to such areas of the economy as the degree of permissible private enterprise, how investments are handled, the question of who determines prices, the degree of autonomy given to enterprises and managers, how managers in fact will be selected, what they are doing in terms of agriculture. If you compare what Gorbachev has done and is attempting to do in the Soviet Union, how does it look in relation to what these other countries have done and has Gorbachev in fact initiated any economic reforms that have not already taken place in some of these other countries?

Mr. **Simons**. Congressman, you have me at a disadvantage. I'm not a good enough economist or comparative economist to really give you the kind of answer that you deserve on detail of that.

My impression is, as someone who's watched these things as a noneconomist over the years, that you are dealing with a reform program which differs from East European programs in its comprehensiveness, but is also a kind of a smorgasbord at this point of individual elements.

Representative **Solarz**. Would it be possible for you to submit a much more detailed response to this question? I mean there's a lot of rhetoric floating around and also, unfortunately, a lot of vagueness about exactly what they are doing and I think it would be very useful if we could see in very precise and specific terms what is happening in the Soviet Union in terms of economic reform in comparison to these other Communist countries because that will put in some perspective how far reaching these reforms are.

Mr. **Simons**. Let us try to develop and submit that.[1] You also have expert witnesses who I believe have already appeared before this committee.

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[1] See Mr. Simons' letter of response at the end of the hearing day.

ECONOMIC SAVINGS FROM THE INF AGREEMENT

Representative **Solarz**. Now I'd like to relate the whole question of arms control to the Soviet economy. To what extent is the Soviet interest in arms control a result of the Soviets hope to achieve savings in defense spending that could be made available for the domestic economy if arms control agreements can be achieved.

It's not clear to me to what extent this is based on fact or myth. For example, let's start out with the INF agreement.

Do you see any savings for the Soviet Union in the kind of INF agreement which is rapidly reaching completion?

Mr. **Simons**. No.

Representative **Solarz**. Economically?

Mr. **Simons**. No.

ECONOMIC SAVINGS FROM THE START AGREEMENT

Representative **Solarz**. Now supposing we get a START agreement providing for a 50-percent reduction in strategic weapons along the lines that have been discussed with a meeting of the minds on sub subtotals, subsystems and the like. Do you see any savings there for the Soviet Union?

Mr. **Simons**. I think there probably would be some savings there. It's hard to tell how substantial they would be, more pertinently, it's difficult for us to discern what they would intend to do with those savings. In order words, there has been debate within the Soviet military in recent years about what their main priorities ought to be.

Representative **Solarz**. The savings, if there are any, could go into enhanced conventional weaponry or in other nuclear weapons development or the domestic economy.

Mr. **Simons**. That's right.

Representative **Solarz**. But when you say there may be some, what kind and what would they result from? What would the savings be?

Mr. **Simons**. Well, I would be——

Representative **Solarz**. As an order of magnitude?

Mr. **Simons**. I don't have that. I'd have to seek that out.

Representative **Solarz**. Could you get back to us on that?

Mr. **Simons**. Yes.[1]

Representative **Solarz**. Essentially, what would the savings derive from? Reduced manning requirements for these systems? You get rid of 50 percent of your SS-18's?

Mr. **Simons**. Well, I think manning requirements and production requirements for replacement systems——

Representative **Solarz**. As an order of magnitude, though, my sense is it is probably relatively modest. Can you get back to us on that?

Mr. **Simons**. Yes.[1]

Representative **Solarz**. Not only in terms of the absolute amounts, but what percentage that is of their defense budget and the like.

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[1] See Mr. Simons' letter of response at the end of the hearing day.

ECONOMIC SAVINGS FROM THE CHEMICAL AGREEMENT

Now what about the chemical treaty. I gather real progress has been made on that. If there's a chemical agreement, would that result in any significant savings?

Mr. SIMONS. Once again, I don't have figures on what the chemical weapons effort costs the Soviet Union. I imagine it's fairly small.

ECONOMIC SAVINGS FROM SPACE AGREEMENTS

Representative SOLARZ. Supposing we get an agreement along the lines they have suggested on the space talks, which would in effect restrict either the kind of specific tests and development that could be conducted with respect to defensive technologies or their proposal to accept restrictive interpretation of the ABM treaty? Have you any estimate of what that would save them in relationship to the broader interpretation of the ABM treaty under which we're prepared to operate?

Mr. SIMONS. I don't, because I think the judgments would also depend on other evaluative judgments concerning where a defense program or a space program would go even with certain limitations. In other words, you have a pop-out effect.

ECONOMIC SAVINGS FROM CONVENTIONAL ARMS REDUCTION

Representative SOLARZ. If you could get back to us on that. Then, finally, supposing we had a conventional arms reduction agreement of substantial magnitude, approaching the levels envisioned by the Budapest Appeals. Could you give us an estimate on what kind of savings that might produce? [1]

Mr. SIMONS. Well, Congressman, once again, I don't think that there's going to be the kind of unambiguous answer you seem to be looking for because even if you reduce manpower levels, if you use the money for new weaponry or R&D technology in the conventional field, you will have no net saving in that sector.

Representative SOLARZ. I understand that, but you at least begin with money you save from the reduction in manning requirements and then you have to determine how to allocate it. But I'm really trying to make a judgment about whether there's any truth to the notion that to some extent the Soviet leadership is driven toward an arms control agreement by the need to secure savings in defense that could be made available to domestic economic investment.

POLITICAL OBJECTIVES FOLLOWING REFORM

Let me ask you finally, you laid out I thought very clearly the dilemma we all face in assessing the implications to the United States of Gorbachev's reform program. Will it over time lead to the emergence of a more benign, as you put it, more democratic Soviet Union or will it simply enable the Soviets to revamp their economic structure in such a way as to ultimately make them a more effective and formidable threat?

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[1] See Mr. Simons' letter of response at the end of the hearing day.

What evidence do we have, based on history or anything else, that in fact the kind of economic reforms being envisioned in the Soviet Union could or are likely even to lead to a more benign foreign policy?

Mr. SIMONS. I think the only—because the East European countries which have embarked upon reform have not had the same foreign policy stature or ambitions as the Soviet Union has had, that's not an adequate parallel there.

Probably the only parallel would be a state like China, which has embarked on an ambitious and far-reaching reform and pursued it over a number of years, and I believe also that has had some effect upon their military planning and sort of structure operation.

But I think it's difficult to draw parallels of that kind because the individual interests of individual countries are so specific, so it's an intellectual exercise which may not have much significance in projecting policy or policy options.

On the other hand, Congressman, I don't think it's foolish to entertain the hope. I think it's important to be very careful. But one of the things I believe about democracy is that democracies probably are more peaceful participants in world affairs than dictatorships have been. Now a certain amount of that is an article of faith because democracies have been engaged in wars as dictatorships have throughout their history, but it seems to me that democratic states of a kind that we would recognize as democratic, states that treat their citizens well and that care about democratic values internally, are less likely rather than more likely to be aggressive and threats to their neighbors or threats to the peace. So I think it's on that basis.

Senator PROXMIRE. Well, thank you very much, Mr. Simons. You have been very helpful. We appreciate your testimony.

Mr. SIMONS. Thank you.

Senator PROXMIRE. Our next witnesses will appear as a panel. Jerry Hough, professor of political science, Duke University; Herbert Levine, professor of economics, University of Pennsylvania; and Edward Luttwak, senior fellow, Center for Strategic and International Studies. We are very honored that you distinguished scholars are appearing this morning.

As I indicated, Mr. Luttwak, I didn't have an opportunity to peruse your prepared statement in advance, but I must say that Mr. Levine and Mr. Hough have done what I think is a very outstanding job in their presentations.

We will start with Mr. Hough and then move right across the line.

STATEMENT OF JERRY F. HOUGH, JAMES B. DUKE PROFESSOR OF POLITICAL SCIENCE, AND DIRECTOR, CENTER ON EAST-WEST TRADE, INVESTMENT AND COMMUNICATIONS, DUKE UNIVERSITY; AND STAFF MEMBER, BROOKINGS INSTITUTION

POLITICAL EXTREMISM

Mr. HOUGH. Thank you very much.

The first half of my prepared statement focuses on the argument that reform in the Soviet Union is extremely fundamental. I think that in the past we've correctly understood that left-wing extremism and right-wing extremism—that is Stalinism and Nazism—are very similar, and if we talk about this in contemporary terms, we can say I think correctly that the Communist revolution in 1917 was the Khomeini revolution of Russian history. That is, it was a profound anti-Western, xenophobic revolution that created two iron curtains, one against frightening Western ideas, satanic Western ideas, the other against frightening Western market forces.

SOVIET POLITICAL EVOLUTION

And it seems to me that what has occurred in the Soviet period as we've known it has not been the natural expression of Russian national character. Russia in the 19th century was very open to the West, dominated by the Westernized lead Peter the Great had created. That what we've known really is the Khomeini period in Russian history and that it's over for several reasons. Most important, it's over because if you do what the Soviets did, which is create monopolistic ministries and give them total protection from foreign competition you get precisely the kind of inefficiency, lack of innovation, lack of responsiveness, that one has seen in the Soviet economy.

And if you've going to do that, there's no way that you can be a great power. Everything that Gorbachev says indicates he clearly understands this.

GORBACHEV AS STRONG AS STALIN

Now this is a highly controversial position, but I think it would not be controversial if we remembered some old and simple truths. The first is in my prepared statement which you have already quoted; namely, that the Soviet Union does have a dictatorial system, and you quote me correctly in saying that I do think that Gorbachev is as strong as Stalin in 1928–29 and that he's about to conduct a transformation as big as 1928 or 1929 but in a different direction.

He is going to ease the Peter the Great reopening of Russia to the West, if Stalin was the man who helped close it.

It seems to me that without realizing it we have essentially become Marxist in understanding the Soviet Union. Essentially, we have learned from the dissidents, from the immigrants, who were trained in Marxism, who applied it to the Soviet Union. Instead of seeing power in the hands of those who owned the means of production, they have seen power in the hands of those who manage the means of production. That is, the bureaucrats.

They see this as a ruling class which cannot be challenged, just as, of course, Marx said that the Congress is a tool of Wall Street, they see the political super-structure of Gorbachev essentially as a tool of this ruling class. I think this Marxist image of the Soviet Union is as wrong as the Marxist image of the United States.

SUPPORT FROM BUREAUCRATS

In the past, we talked not about bureaucrats, but about an educated, repressed middle class. We understood that they wanted more openness, that they wanted more freedom. And I think this is true, that what one sees in the Soviet Union is an educated middle class, working in the bureaucracy, working as intellectuals were very much like their counterparts in Argentina, Brazil, and South Korea. That is, I think the so-called bureaucrats want more change than Gorbachev, that Gorbachev's real opposition, if you're talking about 1990, is not conservations who are politically impotent; the real opposition that he has to worry about is the liberal middle class because it has grown enormously and his problem is how to keep a clogged spring from going into a clogged summer.

RUSSIANS WANT TO BE COMPETITIVE

The second ancient truth that I think we have to begin with is that Russians want to be No. 1 or at least they want to be equal. Some used to say that Russia wanted world domination. The Chinese drive for modernization has essentially created a situation in which the Russians are scared because it's not that they're not equal with the United States or Japan, they're not even equal with South Korea in the ability to export technology, TV sets and cars to the United States.

This creates shame, but it creates enormous worry in the face of Chinese modernization and this is the situation that it seems to me that the Russian character will not for long tolerate.

PROTECTIONISM STIFLES INNOVATION

There's a third ancient truth that we've forgotten and I've already alluded to it; namely, the protectionism is disastrous for innovation.

What we've known but not known is that the Soviet Union has provided such total protection for its industrials that it makes Japan look like an open economy. At least considerable foreign investment is permitted inside Japan and at least Toyota and Sony must compete with foreign firms in foreign markets.

Soviet manufacturers face no foreign investment at home. They have been under no pressure to export. Even when foreign machinery is imported, Soviet manufacturers lose no business. Everything that's said about the inefficiency of the Soviet economy simply confirms what the free trade textbooks say about the consequences of massive protectionism.

If Gorbachev is to raise Soviet technology anywhere near world levels, he absolutely must attack protectionism head on. He must push an export strategy like Japan and South Korea. He must begin integrating his production into the world economy, first with Soviet plants producing parts the way Mexico and Singapore do, and increasingly with Soviet plants procuring parts in an area with lower labor costs.

Once he gets his industry reorganized well enough to use it, he must assume massive foreign loans and he's already beginning to permit foreign investment.

There are a wide range of consequences for an attack on protectionism. For example, Japan sends more tourists abroad than the United States, even though it has one-half the population, and that's what you need to do if you're going to have an export strategy.

The Soviet Union, too, must go that route if it wants to understand world tastes enough to export and it has to do it if China is not to outstrip it.

IMPLICATIONS FOR THE UNITED STATES

What are the implications of this for us? First, of course, I think we need to start taking Gorbachev seriously. There is enormous smugness in this country, enormous self-satisfaction, enormous complacency, a real tendency to sneer and to put down all the time.

I must say I found the testimony that you just heard rather disappointing from this point of view. People ask the question, who's optimistic, who's pessimistic about Soviet reform? Those who claim to be pessimistic are seen to me to be profoundly optimistic from an American point of view. There's a profound wishful thinking that Russia is going to continue to muddle down, that there's never going to be any challenge for us, that we don't have to worry, that we can just stay the course.

It seems to me that until we comprehend that we have a worthy opponent, he's going to continue to blow us out of the water the way he has the last 2 years.

TECHNOLOGY TRANSFER AND JOINT VENTURES

The second implication flows from the Soviet need to attack protectionism, and this involves problems of technology transfer. The problems of technology transfer, of loans and the like, simply go vastly beyond the policy problems of the 1970's. Joint enterprises with 51 percent—49 percent ownership involve an intimacy of technology exchange, a constant updating of technology and product that goes well beyond the sale of equipment.

They involve this updating of product and technology. They involve a continuous effort to improve the performance of Soviet supply plants that raises technology transfer questions at every stage of the operation.

Moreover, a country that worries that interest rates on loans might be lower then prevailing market rates will have even more questions about direct capital investment that has no guaranteed return whatsoever.

If the Soviet Union must attack protectionism in order to begin to try to catch up with South Korea and if the United States continues to try to retard this process, the Soviet Union absolutely must make every effort to break the American technological blockade.

SOVIET VIEW OF NATO

I think this is a point that's absolutely crucial to understand. We've had a real tendency to think of Soviet goals in Europe as simply the breaking up of NATO or at least the Finlandization of NATO and it seems to me we've been absolutely—absolutely the reverse was true about Brezhnev's policy and the absolute opposite is true about Gorbachev's policy.

At some conscious or unconscious level, Brezhnev and his generation came to perceive NATO not so much of a threat but as a reassurance that West Germany was under American control. They feared that the dissolution of NATO would soon lead to inexorable pressures inside West Germany to have nuclear weapons as counterparts to British and French weapons. They needed a justification for troops in East Europe and they thought that a dissolution of NATO would make the prevention of a united Germany more difficult. And Gorbachev has said exactly the same thing.

SS-20'S SOLIDIFY NATO

We just have not absorbed this. We have talked in recent years as if large Soviet conventional forces and the installation of SS-20's were aimed at the Finlandization of Western Europe. The balance of power theory would predict precisely the opposite; that if you have a threat, that will solidify an alliance. And it seems to me that that's been precisely the purpose of the SS-20's, precisely the purpose of the conventional forces, not to Finlandize Europe but to preserve NATO.

What creates the danger today is not the withdrawal of Pershing missiles. What creates the danger of decoupling today is the withdrawal of Soviet SS-20's and Soviet short-range missiles. If Europe no longer feels threatened, that's what weakens the cement in the military alliance.

It has been the foolish American demands for zero options that have been creating the danger of decoupling because we're demanding that the Soviets pull out missiles which are essentially in our interest. And it's been the United States, incredibly, that has pushed for a 3-year withdrawal period when the Soviet Union wanted 5 years.

Think of it. The Soviet Union used to treat the Pershing II as one of the most dangerous first-strike missiles in the world, but now it wants to keep them in Europe for 5 years when the United States was pushing for 3 years.

It seems to me the reason that the Soviet Union has had to accept an increased risk of decoupling is that an INF agreement legitimates and facilitates the compact with American allies that is crucial for its foreign economic policy.

CONVENTIONAL FORCE REDUCTION

The primary Soviet objective in the recent INF talks was the achievement of Erich Honecker's visit to Bonn in early September and then Eduard Shevardnadze's visit to Brazil and Argentina in late September. The real Soviet objective it seems to me was to stimulate Western talk about the Soviet conventional threat so that it can force NATO consideration and eventually acceptance of a major reduction of conventional forces in Europe, which as Congressman Solarz has indicated, is really the only way they are going to save money and they need to save money.

It seems to me that if we want to thwart their goal of reintegrating into the world economy, they are going to be driven to steps that are going to risk the breakup of our alliance, that they essentially have the cards in their hands, and that we must begin to understand that this attack on protectionism which is crucial, absolutely crucial, if they are to be serious as a world power, is going to be very, very clear. It's a very natural movement as they reintegrate into the world after this Khomeini period. And I think we have opportunities and dangers which I spell out in the second half of my prepared statement which seem to me that we need not simply to say we're going to stay the course, nothing is going to happen, the reform won't work. I think we need far more serious consideration of our problems now.

[The prepared statement of Mr. Hough follows:]

PREPARED STATEMENT OF JERRY F. HOUGH

In recent years our thinking about the Soviet Union has become extraordinarily confused. People talk about a threatening Soviet Union, one perhaps still driven even to world domination, but then say that it will not take the industrial reform that is indispensable for a maintenance of the threat. People say that Gorbachev's effort at reform obviously will not work, but that we should impose controls to restrain greater Soviet integration into the world economy because otherwise this non-effective reform will transform the Soviet military capability in a few years. When people say that the reform is politically impossible, it is either because the Russian people are so inert and conservative that they won't take the risk of setting up a private restaurant or else because they are so revolutionary and reckless that they will stand up before tanks to riot against a 20 percent rise in meat and bread prices. And, of course, if Gorbachev does not show success and transform the economy in three years, he will be overthrown by the second secretary, Yegor Ligachev - who, strangely enough, is said to be conservative and not to want the economy transformed in three years, or even four or five.

One could go on. In the realm of Soviet-American relations, Gorbachev is said desperately to need to save money on defense and that is why he pushes for five-year dismantling programs of rather meaningless missiles that won't save any money. He supposedly has a deep fear of SDI, not because he thinks it will work but because its technological spinoffs in other military spheres are so threatening. That is why he wants us to stop wasting money on testing and deployment so that we can concentrate our efforts on the research that will maximize the spinoffs. And since early 1985 people have said that Gorbachev desperately needs a foreign policy success so he can strengthen his political position at home. He still has that desperate need even though he has blown us out of the water in the propaganda war in Europe and has had the fastest change of top personnel of any new General Secretary in Soviet history. One shudders to think how strong he would be if we had not weakened him by delaying arms control agreements these two years.

If it weren't all so serious, all these contradictions would be worth a good laugh, but unfortunately, it is serious. All this wild contradiction says far less about the Soviet Union than it does about us. It says that we are in a state of very considerable anxiety, facing a world that we don't understand and simply thrashing about. We haven't even settled down enough to think seriously about what's going on in the Soviet Union.

Since Gorbachev's political position at home is now enormously strong — I would say as strong as Stalin's in 1928-1929 — he is now in a position to make far bolder foreign policy steps. He has not made so many concessions in the INF negotiations because that strengthens his political position at home (such concessions could create worries that he might be a weak leader and undermine his position); instead, the concessions reflect the fact that he is politically so strong that he doesn't have to worry as much about the domestic costs of the concessions. He is strong enough now to begin the powerful moves of the middle game of his chess strategy. I believe now — even more strongly -- what I wrote in the Fall of 1985 in Foreign Affairs: Gorbachev has had a deliberate, well-calculated domestic and foreign policy strategy from the beginning and he is "a truly world-class chess player who delights in complex combinations and knows how to make them."

I.

Fortunately, as we try to understand Gorbachev, the task is not nearly as difficult as we have been making it out. All we have to do is to remember a few very simple truths that we learned in college or in the newspapers in the 1950's and 1960's.

The first old truth is that the Russian people yearn to be number one or, at least, second to none. It probably would be wrong to think Russians still harbor illusions about dominating the whole world, for we have all learned that if neither the United States nor Syria can control tiny Lebanon, the whole world is beyond us. But the Russian people sacrificed enormously to catch up. It is a profound misreading of the Russian character to believe that they don't mind falling behind even countries such as South Korea in their ability to produce and export quality television sets and that they will now be content simply to "muddle down." They don't just yearn for equality and even superiority; they burn inside for it, and especially in the face of Chinese modernization, they will not settle for being the last Third World country.

The second old truth is that proclaimed daily by the Wall Street Journal: protectionism is very bad for innovation, efficiency, and growth. The Soviet manufacturers for over 60 years have had a degree of protection from foreign competition that makes Japan look like an open economy. At least considerable foreign investment is permitted inside Japan, and Toyota and Sony must compete with foreign firms in foreign markets. Soviet manufacturers face no foreign investors at home, and they have been under no pressure to export. Even when foreign machinery is imported, Soviet manufacturers lose no business. Everything that is said about the inefficiency in the Soviet economy simply confirms what the free trade textbooks say about the consequences of massive protectionism.

If Gorbachev is to raise Soviet technology anywhere near world levels, he absolutely must attack protectionism head-on: he must push an export strategy like Japan and South Korea; he must begin integrating his production into the world, first with Soviet plants producing parts the way Mexico and Singapore do and increasingly with Soviet plants procuring parts in areas with lower labor costs. Once he gets his industry reorganized well enough to use it, he must assume massive foreign loans. There are a wide range of consequences of an attack on protectionism. For example, Japan sends more tourists abroad than the United States even though it has one-half the population, all bringing back pictures with their cameras. The Soviet Union too must go that route if it wants to understand world-tastes enough to export to it. It must, if China is not eventually to become technologically more sophisticated.

The third old truth is that Brezhnev and his generation were insecure old men who feared Western ideas (even non-political culture like rock-and-roll and abstract art) and who had a special, visceral fear of Germany and Japan because of their memories of World War I and World War II. Associated with this cliche was our 30-year-old stereotype of Soviet youth as people who did not fear Western ideas and fads, but thirsted after jazz and rock-and-roll and blue jeans and Western films and the like.

One of the most perceptive of the Western observers, Edward Crankshaw, expressed the point in the following manner:

> Nothing in this world is more depressing to contemplate than the average Soviet official of high or low degree at present between the ages of forty and sixty. ... Those who started their rise in their thirties during the great purges ... are incomparably the worst. The Soviet Union's greatest hope lies in the young - those under thirty-five ... In a dozen professions in which party control is particularly rigid, in journalism, in economics, in the higher civil service with its many branches, in the armed forces, in the universities' faculties, you will meet well-turned out young men in their thirties, usually Party members, relaxed and easy in manner, often with a pleasantly ironical approach to life, and very much in touch with realities of every kind. I have been talking of the cream of the younger men beginning to rise in what are called the liberal professions and the state and party service. Until the last decade, young men of comparable ability would not have dreamt of this sort of career.

It sounds very much like Ambassador Hartman's analysis of the contemporary Soviet Union. But Crankshaw was writing in 1959. Those between 40 and 60 then were born between 1900 and 1920: they were the Brezhnev-Grishin-Shcherbitsky generation. Those under 35 were born in 1923 and later. The new man in journalism Crankshaw was describing was a man like Genady Gerasimov, 30 years of age at the beginning of 1959; the new man in the foreign service was a Yury Dubinin, then 28; the new man in the party apparatus was an Eduard Shevardnadze, then 30, or Mikhail Gorbachev, then 27; the new man in the military was a Dmitrii Yazov, then 35.

In talking about the Soviet youth for so long, we have forgotten the extraordinarily unfortunate fact that people get older in 30 years. The young men of ability who would not have entered the state service under Stalin, who had a self-confidence their elders did not, who liked Western fashions and exposure to the West are now the Soviet Politburo and Central Committee members and the supposedly conservative bureaucrats. In fact, the bureaucrats under 60 should be seen as the educated middle class, who (like their counterparts in Argentina, Brazil, and South Korea) want more change than the leader. For the bureaucrats, the ancient drive for warm-water ports has given way to the drive for warm-water beaches — on the Riviera, on Capri, in the Greek Isles.

The fourth old truth that we need to remember is that the Soviet political system has very few restraints on the leadership. We now accept a new image of the Soviet system: a Marxist view that we have picked up from Soviet dissidents who were trained in Marxism and then applied it to the Soviet Union. In this view, all power is not in the hands of the owners of the means of production, but in the hands of those who control and manage the means of production — the bureaucrats. This economic ruling class has only one interest — its economic one — and the political system is a superstructure that is a tool of the ruling class. Hence the notion that Gorbachev can overcome bureaucratic resistance is as foolish as the notion that Congress has any independence from Wall Street.

In my opinion, Marxism is as bad a guide for understanding the Soviet Union as it is the United States. Indeed, it is worse, for at least in the United States, Wall Street does have some votes and some campaign contributions, and this gives it some political leverage. Our old truths emphasized that the Soviet political system has no Congress, no Supreme Court, no checks and balances, no elections. Instead, it has a General Secretary who has control over the political machine in the party apparatus and hence enormous power in the Central Committee - and, therefore, over the Politburo. Even a buffoon such as Khrushchev who took off his shoe in the United Nations to pound it on the table had to offend every important institutional interest group in the Soviet Union, and he had to lose China and bring Russia to the brink of war twice, first in Berlin and then in the Cuban missile crisis, before the leadership finally moved against him after 11 years in power.

To repeat, these are old and simple truths: the Russians have a drive to be number one, and only an attack on protectionism can keep a country's technology competitive. The educated middle class, under 60 have wanted access to the West since they were young, and they are suppressed in a dictatorship in a way that makes them very underprivileged in comparison with their counterparts in the West. They can now tell the leaders, the conservatives, and the military that only an attack on protectionism, an opening to the West, will preserve Russia's position as a great power. And, of course, the Soviet Union has an extremely powerful dictator who wants to rule in the year 2000 as head of a powerful nation and who has few restraints that will prevent him from giving the bureaucratic middle class much -- but not all -- of what they want.

If we could have cleared our heads of our new Marxist view of the Soviet Union and gone back to those simple truths, we would have had little problem in predicting what generational change would mean and the speed of Gorbachev's consolidation of power. Indeed some of us who remained old fogeys did have little such problem. And, as Gorbachev repeatedly tells us, we have only seen the first small steps. Far more is to come, and the change is absolutely durable. It is extremely doubtful that Gorbachev wants a democratization that will undercut his control of his political machine, but virtually each month we will continue to see things we would have thought impossible five years ago.

In short, we are at the end of an era. First Russia is at the end of an era. Left-wing extremism and right-wing extremism are very similar, and that correctly means that the Communist Revolution in Russia in 1917 had many similarities to the Khomeini Revolution in Iran. Both were essentially anti-western, xenophobic revolutions aimed at protecting frightened, first-generation city dwellers from the insecurities of "satanic" western ideas and western market forces. But now the "Khomeini period" in Russian history is over, and a confident, new generation is going to end the self-containment of Russia that was at the same time so frightening and so reassuring to us. A Russia that is trying to destroy iron curtains will be as unsettling as the one that erected them, for we are facing a phenomenon that we still think is impossible and do not understand.

We are also at the end of an era in another sense — the end if the postwar world. Those who remembered the diplomacy that led to World War II and who had their ideas formed in the pre-nuclear age were, consciously or unconsciously, obsessed with the problem of ending the conflicts between Britain, France and Germany that destroyed the world twice in a quarter of a century. In a sense, the Brezhnev generation of Soviet leaders and the Kennedy-Reagan generation of American leaders (and both were the new generation, born at the beginning of this century, that President Kennedy talked about in 1960) unconsciously cooperated in ending the problems that tore apart their youth twice, but they were too old when nuclear weapons were developed to really assimilate their meaning in their souls. (General Secretary Brezhnev was 39 in 1945, President Reagan was 34, and President Kennedy was 28). This obsession with conflicts inside Western Europe and the problem of dealing with the nuclear age with pre-nuclear perceptions defined the postwar world, but it is now passing into history.

II.

Change in the Soviet Union has many implications for us, but two are crucial.

First, of course, we face a worthy adversary for the first time in years. We liked to scare ourselves with talk about Soviet expansionism and internal decline, but Gorbachev knew better. The Soviet international influence declined under Brezhnev along with its domestic decline. The only Soviet expansionism of note in over a decade has been into bogs.

Now the situation is different. If Gorbachev is playing chess and looking three-four moves ahead, then we have to stop playing chess looking ahead only one move. And those who think that we are still playing checkers should adjust their glasses and notice that while the board is the same, the pieces have been changed on us. It is not enough to look at the first steps of reform and assume that they are the last; it is not enough to look at the distance covered in the last two years of economic reform and assume that the pace will stay the same. We must assume that Gorbachev is intelligent, that he can see the same imperatives we can, and that he will follow his self-interest in doing what is necessary.

Of course, it is always possible that we will be lucky. Perhaps Gorbachev's drive is more limited than it seems or his capabilities less. But what does it hurt to assume that he is a worthy opponent? To continually lower expectations about him is to make him look better than he otherwise would. Coach Gibbs of the Washington Redskins knows better than to say that his next opponent is weak and incapable of solving its problems, and presidential candidates know better than to claim a big vote before the Iowa and New Hampshire primaries. But in international relations we follow very different rules of behavior, and it has been costing us dearly.

The second key implication for us flows from the Soviet need to attack protectionism. Joint enterprises with 51 percent/49 percent ownership involve an intimacy of technological exchange that goes well beyond the sale of equipment or even turn-key plants. They involve a continuous updating of product and technology, a continuous effort to improve the performance of Soviet supply plants that raises technology transfer questions at every stage of operation. Moreover, a country that worried that interest rates on loans might be lower than prevailing market rates will have even more questions about direct capital investment that has no guaranteed return whatsoever. If the Soviet Union must attack protectionism in order to bring its technology to world levels and if the United States continues to try to retard this process, the Soviet Union must make every effort to break the American technological blockade.

In addition, if the Soviet Union is to expand its investment while preventing consumption from falling, it cannot limit itself to the kind of nuclear arms control to which we are accustomed. Whether one approves such arms control or not, it obviously has little economic effect, one way or the other. The only way to save significant sums of money is to cut conventional military forces, and a reduction of the conventional threat to Europe is also crucial to reassure Europeans that their long-term investments in the Soviet Union are desirable and safe. After 20 years of concentrating our attention exclusively on nuclear arms control, the government and arms control community have little knowledge about the intricacies of conventional arms control, and we will be asked to make decisions on crucial subjects where we have not thoroughly analyzed the pluses and minuses — and are not now.

It is absolutely crucial that we understand this aspect of Soviet policy. Over the years we have engaged in a lot of talk about Soviet efforts to break up NATO, and, while this analysis was useful tactically, it had the unfortunate effect of convincing us as well as others of its truth. In fact, at some conscious or unconscious level, Brezhnev and his generation came to perceive NATO not so much as a threat but as a reassurance that West Germany was under American control. They feared that the dissolution of NATO would soon lead to inexorable pressures inside West Germany to have nuclear weapons as counterparts to British and French weapons. Furthermore, the Soviets needed a justification for troops in Eastern Europe, and they thought that a dissolution of NATO would make the prevention of a united Germany more difficult.

In short, it was not paradoxical that Andrei Gromyko was able to retain his job for 28 years, despite being so clumsy and ineffective in his efforts to weaken the

NATO alliance. He actually achieved precisely what he and his masters wanted: the preservation of NATO and the maintenance of American control over Western Europe, especially West Germany. All the talk about "German revanchism" was not based on any misperception of Nazi remnants in West Germany at the time nor even about the likelihood of a rise of a new Hitler, but about the dangers of nuclear proliferation to Germany in the future and its political consequences.

In this respect, Gorbachev is no different. He has repeatedly denied that he wants to break up the NATO alliance, and he is sincere since it is in Soviet security interests. However, he has no choice but to break the American technological blockade. If he is forced to risk the military decoupling of the United States and Western Europe in order to get access to Western markets and Western capital, he will do so. But he fears the military decoupling and understands it is not in Soviet interests.

It is absolutely crucial that we begin thinking clearly on this point. Balance-of-power theory has always said that a threat by one country tended to be met by countervailing alliances against the threat, and that theory has worked very well in explaining European international relations for the last 40 years. The Soviet Union has been perceived to be threatening — and it certainly has done little to reduce that perception — and, as a consequence, NATO has turned into the longest-lasting military alliance in history. At one level we understand this, but at another level we do not. We have talked in recent years as if the large Soviet conventional forces and the installation of SS-20s were aimed at the Finlandization of Western Europe. Balance-of-power theory would predict that they would have precisely the opposite impact, and, in reality, they have.

This is a point critical to understand at the present time. We talk about the withdrawal of Pershing-II missiles as possibly leading to a decoupling of Europe and the United States, but, except to the extent that foolish statements on our part become self-fulfilling prophecies, there is no theoretical reason for this to occur. What creates the danger of decoupling is the withdrawal of the Soviet SS-20s and short-range missiles. If Europe no longer feels threatened, that is what weakens the cement in the military alliance. It has been the foolish American demands for zero options that have been creating the danger of decoupling, and, incredibly, it has been the United States that has pushed for a three-year withdrawal period when the Soviet Union wanted five. Think of it. The Soviet Union used to treat the Pershing-II as one of the most dangerous first-strike missiles in the world, but now it wants to keep them in Europe for five years when the U.S. was pushing for three.

The reason that the Soviet Union has unwillingly had to accept an increased risk of a decoupling is that an INF agreement legitimates and facilitates contacts with American allies and furthers its foreign economic policy. The primary Soviet objective in the recent INF talks was the achievement of Erich Honecker's visit to Bonn in early September and Eduard Shevardnadze's visit to Brazil and Argentina in late September. The real Soviet objective was to stimulate Western talk about the Soviet conventional threat so that it can force NATO consideration and eventual acceptance of a major reduction of conventional forces in Europe.

III.

What does America do in these circumstances? First, of course, it has to cut through the cliches that we have had for decades about Europe and think very seriously about the evidence. Does the Soviet Union have an interest in American withdrawal from Europe in an age when the only military threat to security comes over the North Pole and when the Communization of Western Europe after a Soviet victory would increase the number of countries likely to have Solidarity-like movements and decrease the number that can send the Soviet Union high-technology goods? Was the hypothesis about a Finlandizing effect of Soviet conventional forces and SS-20s confirmed by actual events, or did these events confirm the predictions of the balance-of-power thesis? Would the end of a Soviet military threat to Europe really strengthen the NATO alliance and will the massive withdrawal of Soviet missiles not affect the perception of threat? And, most basically, do we really know what we are doing in our policy? I have my answers, but at a minimum these are questions that must be considered in the most serious way at what is a crucial moment in history.

In my opinion, an analysis of proper American policy towards the Soviet Union must begin with a sober assessment of our very limited capability to stop Soviet re-integration into the world economy if it is serious. The Soviet Union has many cards to play. Already East German tourism to the West is soaring, and such steps can buy much in the West. As in the INF agreement, the United States can force the Soviet Union to accept steps not in American interests but there is no need to do this if the United States is sophisticated.

Although theoretically there is a danger that the United States will become naive about the Soviet Union in the face of the Gorbachev peace offensive, the greater dangers lie in the opposite direction. For too long Americans have had a tendency to think that they have only the single foreign policy interest of opposing the Soviet Union - that, to quote President Reagan, the Soviet Union is the focus of all evil. As Soviet fanaticism declines, as nuclear stability is achieved, as other challenges become proportionately more serious, the greater danger is that we will continue to think of the Soviet threat as the only one on which to focus all our thought and energy.

In fact, there are other, very major foreign policy challenges. First, as military power has become more difficult to use in the nuclear age and as intercontinental rockets have reduced the importance of other military considerations for a superpower, economic power has assumed a proportionately larger role in national power and even national security. For a long time American economic superiority has made us complacent about this facet of national power, but the Japanese focus on economic growth at the expense of military power has had economic consequences that increasingly will have political consequences. With the United States becoming the world's greatest debtor country, the question of the trade deficit has become a foreign policy, national security problem as well as a domestic one. It is conventional disarmament, not nuclear, that can solve our deficit problems.

Second, the problem of fanatic extremism remains a serious one, but Iran reminds us of a fact that we knew in the 1930's and 1940's, but forgot in the 1950's and 1960's. Right-wing extremism can be as bad as left-wing extremism, and , indeed, as the theory of totalitarianism said, they have much in common. The experience of this century suggests that, except in special circumstances, Walt Rostow was right in calling Communism or left-wing extremism "the disease of the transition" - often really the earliest stages of the transition. Countries such as Afganistan, Angola, Ethiopia, Nicaragua, and Yemen are really pre-industrial. Right-wing extremism, by contrast, is more a problem in middle stages of industrialization, as shown by the experience of Japan, Spain, Italy, and Argentina in the 1930's and Iran in the 1970's. Since the number of important, pre-industrial countries is rapidly declining, the more typical disease of middle stages of industrialization is likely to be our biggest worry over the next half-century. Certainly the right-wing extremism of Islamic fundamentalism is a major worry today.

Third, if the Soviet Union is going to adopt a less threatening posture, this is going to create new challenges in the industrialized world. Like the Soviets, we have no interest in nuclear proliferation to countries such as Germany and Japan, let alone the revival of serious conflict within Western Europe. The problem, however, goes deeper. As some of the Japan-bashing of the last year indicates, economic conflicts among nations can easily take on emotional, political overtones, and it is not hard to imagine that in the wrong circumstances careless leaders might let emotions get out of hand. The existence of a common military threat from the Soviet Union has greatly facilitated the management of these economic conflicts, for Japan is basically seen as a friend and an ally, regardless of economic problems. The decline of a Soviet threat complicates the management task, and it may not be a coincidence that the rise of Japan-bashing has coincided with the Gorbachev peace offensive.

In short, while the world has always been multi-polar in the sense that various actors (especially in the Third World) have interests that they pursue, independent of the super powers, the world has now become more multi-polar from the point of view of the American policy maker. In the past, the problems of economic growth, of management of the Western economic community, and of controlling right-wing extremism could be subordinated to the problem of containing the Soviet Union. Indeed, even in the early 1970's when we erred by focusing more on problems such as Angola than on Saudi Arabia and Iran, the Soviet Union under Brezhnev remained essentially isolated behind its iron curtain and was not available for real cooperation in any case. Now the other problems have become increasingly prominent, and now Gorbachev's willingness and even eagerness to re-integrate back into the world economy and to open his country to the flow of world ideas gives us new opportunities.

In the past we have talked about combining competition and cooperation in our relationship with the Soviet Union, but the only cooperation that we really seriously considered was rather marginal arms control. Now on the crucial problems of economic growth, of controlling right-wing extremism, and of management of the

Western economic community the Soviet Union has some very similar interests to our own. We are in a position where we can and must move beyond the postwar period to conduct a sophisticated policy in which we really combine cooperation and competition in our relations with the Soviet Union.

We are beginning to sense this. We have increasingly understood that the Soviet Union is as threatened as the United States by Islamic fundamentalism — perhaps more so. Neither of us has any interest in an Iranian victory in the Iran-Iraq war, and the way to strengthen the moderates in Iran is not to give arms that fuel the hope for victory, but to demonstrate conclusively that the war cannot be won and that the bloodshed is in vain. Both the Soviet Union and the United States (the latter rather belatedly, to be sure) recognized this in agreeing to protect Kuwaiti tankers, and they have been cooperating in various ways. If the cooperation had begun in a more conscious manner and had been conducted in a more sophisticated manner, the United States could be in a less exposed position in the Gulf.

We also have some sense that the Soviet Union and the United States have a common interest in reducing their military spending for domestic, economic reasons. However, this insight is misapplied in analysis of nuclear arms control agreements that, whether good or bad, save no one any money. It has never been grasped just how foolish the Soviet Union and the United States have been in Europe in recent decades. Since the European scene stabilized in the 1960's, there has been no meaningful danger of war, but the two super powers (and the European countries themselves) have been spending huge sums of money on the assumption that World War II is repeatable. And while we have all been refighting World War II, Japan has been pouring its resources into investment and winning World War III. Soviet policy has been the cause of this foolishness, but now that the Soviet Union seems willing to make serious conventional changes in Europe, it is in American interest to cooperate. With our new budget reduction law, a tax increase is our only alternative.

If the possibility of Soviet cooperation with the United States in the Iran-Iraqi war and in reducing military spending has entered public consciousness, there is no awareness that the Soviet Union now has a vital interest in not weakening capitalist economies, but in helping to manage their stable growth. Already in 1982, Georgy Arbatov said on Moscow television that "everybody is dependent on the stability of the international economic system and the international monetary system." He was right. Problems in West European growth spill over into East Europe that is partially dependent on western markets, but the problem goes deeper. The Soviet Union established an iron curtain against western market forces in order toprotect frightened, first-generation workers against the insecurities of the business cycle, and, as Gorbachev re-integrates Russia back into the world economy, he has a vital, domestic political interest in mild fluctuations in the world business cycle so as to minimize the opposition to reform.

In short, if we will accommodate the Soviet desire to end the conventional threat to Europe and dismantle its iron curtains against western ideas and western market forces -- goals we have long proclaimed -- we will find the Soviet Union has an interest in helping us to manage the process in our economic and political relations with the Western community. The great tragedy is that we remain mired in the nuclear arms control negotiations that Brezhnev supported because they were a substitute for and obstacle to reform at home, and in the process we are dissolving some of the cement in the alliance that will be needed as we attack real problems. A long-term, phased and partial withdrawal of nuclear missiles, combined with a reduction of conventional forces, would have served everyone's interests, and it will take skill to get back on course after the zero options.

We do not, I think, need to fear Russian re-integration back into Western civilization and into the world economy. They created the iron curtains, not us;

they created a conventional defense problem in Europe, not us. George Kennan said 40 years ago this month that if we contained the fanaticism and messianism of that generation of Soviet leaders, Russia would eventually change -- not cease to be a great power with antagonistic interests, but change into a more normal great power that does not fear foreign music and foreign newspapers and even foreign restaurants in Moscow. Kennan was right, and we too must move out of the postwar period and not become wedded to means that were needed to achieve the ends that largely have been achieved.

Although we can sometimes nudge the Soviet Union into minor human rights gestures and certain small foreign policy steps in exchange for economic accommodation, we need to go back to even more ancient truths than I have been repeating today. We need to go back to Aesop. In a contest to get a man to take his coat off, Aesop said, the sun will always win over the north wind. If the Soviet Union is moving towards a time when it must and will send millions of tourists abroad, the problem of emigration inevitably changes its character. If the Soviet Union is moving towards an age in which Ukrainians and Latvians and Jews can have their own private restaurants and shops and small factories, many of the problems of restrictions on religious and cultural practice wiull automatically fall. We do not need to be a north wind to promote this process, and it would be unconscionable, I think, to try to be a north wind to stop it -- all the more since a sunny Gorbachev can defeat us if we try.

A modernized Russia will be a greater challenge to us than the declining, self-contained one with which we have become comfortable in dealing. But while I don't think you should believe those economists who talk about the political obstacles to reform and the impossibility of reform, you can believe them when they say it will take years and years before Gorbachev brings Soviet technology to world levels and transforms the character of the Soviet military threat. The key problems for our generation are maintaining American economic leadership and managing economic conflicts within the West in an age with less of a Soviet military threat. Containing extremism remains a key problem, but the most virulent form today is in Teheran, not Moscow. Our job is to concentrate on the promotion of our interests, cooperating and competing with a variety of other countries in different settings in a way that is familiar to participants of Congressional politics and should be the essence of international relations as well. The flexible promotion of one's own interests, not a dogmatic insistence on eternal enemies and eternal friends is the essence of sound international politics as well as domestic.

POLITICAL OBJECTIONS

Senator Proxmire. Thank you, Professor Hough.

Before I call on Mr. Levine, I'm going to yield to Congressman Fish who has to leave. He has an appointment in the House he has to get to, but he has one question he would like to ask you. Go right ahead.

Representative Fish. Thank you very much, Mr. Chairman.

Thank you, Professor. I was glad I could stay at least to this point because you're worth the price of admission.

What I want to find out is, if the Soviet Union's economic reforms do succeed and there is an economically more robust U.S.S.R., should we view that as the emergence of a more formidable foe or should it be something that we look forward to?

Mr. Hough. Well, it seems to me there's a timeframe problem. I do think those who caution that the Soviet economic reform is not going to work overnight are right. That is, the notion that this economy is going to bring their military technology and their technology to world levels by 1990 or 1995—I mean, I certainly don't think the Soviet reform is going to work with that speed. Indeed, whether it works at all, I remain agnostic on that question; or at least particularly if it works in the technology sphere. It's going to work well in the semidecollectivation services realm.

But it seems to me the question for us was that which Gorbachev posed in his Time magazine interview—a great interview which he gave in August 1985, laying out his strategy for grandiose domestic reforms at that time, but saying deliberately foreign policy is a continuation of domestic policy. If we have these grandiose changes in domestic, what does it mean? And he says, "I leave the answer to you."

It seems to me that's the problem; that one needs to worry not that they are going to transfer their economy into something better than the United States or Japan in 10 years, but what are the foreign policy implications? In these respects, it seems to me there's some very good things involved in this.

DANGER OF NUCLEAR WAR

First, I think in a nuclear age there's really no danger of nuclear war if both sides are rational. The danger of nuclear war comes out of fanaticism, irrationality, dogmatism and the like, and to the extent that they are opening to the outside world, I think this is a generally healthy phenomenon.

HUMAN RIGHTS

Second, it's very good for human rights. Many of the problems that ethnic minorities have had in the Soviet Union or religious minorities have come not simply from governmental policy but from the monopoly of the economy. That is, if you're going to permit private restaurants, private shops, if you're going to loosen up the culture where there may be even private theaters and the like, then it's not that hard to have kosher food. It's not difficult for Ukrainians to have their own factory or Estonians to have their own factory, which produce for local nationality tastes.

So, in general, it seems to me that—and perhaps if there is going to be massive Japanese and German investment inside the Soviet Union, that may also relieve some of their pressure on the American economy.

But that whole question of what a Soviet Union coming back into a world economy means, that's a 1990's question. In the short run, I think in terms of the human rights, in terms of reducing the sense of fanaticism, and finally we can begin to solve the problems that we have with our deficit. I think our deficit is the big threat to national interest, the big threat to national security.

UNITED STATES AND SOVIETS REFIGHTING WORLD WAR II

These INF, START—they solve no problem. But if we're in the position where we can reduce the defense budget in a major way by cutting back troops that are no longer needed because the Soviet Union is willing to cut back, I think we can begin to meet the challenge. I sometimes say that we and Europe have been refighting World War II; where we and the Soviets in Europe have been spending money as if we assume World War II is possible again, while Japan has been putting its money into investment and winning World War III. And that's the war I think we should concern ourselves with.

Representative Fish. Thank you.

Senator Proxmire. Thank you, Mr. Hough.

Professor Levine, please proceed.

STATEMENT OF HERBERT S. LEVINE, PROFESSOR OF ECONOMICS, UNIVERSITY OF PENNSYLVANIA

JUNE 1987 PLENUM

Mr. Levine. Thank you, Mr. Chairman.

In my prepared statement, I make a number of comments on the state of the Soviet economy and Gorbachev's program of economic reform. I entitled my comments "Gorbachev's Reform Program: Act II," thus focusing on the rather quantum jump in moving the reform process forward that was taken at the recent June plenum at the end of June 1987.

In my brief oral statement, let me focus, however, on the issues that I understand are among the major issues today; that is, defense and foreign economic relations.

The thrust of Gorbachev's reform program is, in sum, the modernization of the Soviet economy, to be accomplished within a framework of a radical restructuring of the Soviet economic mechanism in the direction of decentralization, with the aim of increasing the long-term competitiveness of the Soviet Union. That is, its economic competitiveness, its political competitiveness, and its military competitiveness.

IMPLICATIONS OF REFORM FOR DEFENSE

Looking first, then, at the defense part of the implications of the reform program, modernization of an economy, modernization of the Soviet economy, requires immense resources to be invested in the civilian economy, especially in the machine-building sector of the civilian economy because the machine-building sector is the fountain from which modern technology spreads through the rest of the economy.

This obviously has an effect on military investment in the usual sense. That is, the usual guns-butter or guns-machinery sense. And it seems to me that Congressman Solarz' question to Tom Simons was looking in terms of the cost of a modernization program and what it might take from defense or in the sense of what cutbacks in defense might save for the economy, was looking in this direction of measuring costs and of measuring costs saved.

TRANSFER OF HIGH-QUALITY RESOURCES

But even more important in the modernization program and the Soviet needs for modernization, is the transfer from the military sector to the civilian sector of high-quality resources, of high-quality human resources and high-quality material resources. These are not priced properly and, therefore, if we look just in terms of the ruble costs of resources moved, we are going to miss a lot of what is involved in Gorbachev's program.

These high-quality human resources are managers, for example. There's been a process in the development of the Soviet economy of the high-priority status of the military, and the process is often successful managers that demonstrate their success in the civilian sector get moved, or in the past have been moved into the military sector; thus depriving the civilian sector of the best of the managers, the best of the engineers, even the best of the machinists, and in these days, the systems analysts.

If Gorbachev is going to be successful in modernizing this economy, these resources have to be moved or some of these resources have to be moved from the military sector to the civilian sector. Also, some of the high-quality materials, the microprocessors, the microelectronics, high-quality steel—this is where the cost of the emphasis on military impact upon the civilian sector and this is where we should be looking for savings from the various arms control activities.

Indeed, it seems to me that the main problem of SDI to Gorbachev, if Gorbachev and the people around him come to the conclusion that in some substantial way they have to match SDI, that the cost is going to be in depriving the civilian of these high-quality resources in addition to the tremendous amount of resources that SDI require.

MAINTAINING MOMENTUM

Furthermore, in terms of the oft-discussed Soviet need for arms reduction and arms control, it seems to me that one major element here is the element of momentum. In my prepared statement, I argue and discuss the difficulties that Gorbachev faces in instituting what is indeed a revolution from above in the Soviet Union; that it will require a long time before efforts are successful.

So the problem of economic reform currently really becomes a political problem. It's a political problem of how to maintain the process of reform. Momentum in this process is very important and, therefore, the movement—the total frontal movement of reform forward is important and this, I think, is a source of a major impact of reform on the military sector in the Soviet Union.

FOREIGN ECONOMIC RELATIONS

Second, foreign economic relations. Without going into any detail of the past problems of overcentralization in the Soviet economy, the foreign trade sector was also overcentralized. Within this monopoly of foreign trade that was possessed by the Ministry of Foreign Trade, the conduct of foreign trade by the Ministry of Foreign Trade and by the subdivisions—these foreign trade organziations—was extremely centralized. In most cases, a Soviet firm buying foreign equipment did not negotiate the deal itself and did not close the deal itself. The intermediary was this foreign trade organization that didn't know the real production problems of the buying Soviet firm and who had in terms of their own incentives some other interests other than just the interests of the purchasing soviet firm.

DECENTRALIZATION

A series of reforms were announced in the summer of 1986, including the broadening of the right to engage in foreign trade negotiations to a number of organizations. That is, to more or less 20 specified ministries and to about 70 specified enterprises. And a commission was set up, the Foreign Economic Relations Commission, to administer these new organizations and some of the old organizations that were involved in conducting foreign trade. That is, the Ministry of Foreign Trade and the Foreign Trade Bank.

Also, a new law on joint ventures on Soviet soil was announced and then published and this Foreign Economic Relations Commission is involved also in administering the joint ventures.

One of the interesting things for people of my generation studying the Soviet economy is that many of us now have associates that were developed when we were both younger who are now—these associates—are now occupying important positions in the Soviet economy.

One of those whom I have known for 15 to 20 years is now in a sense the deputy, but the operating director of the Foreign Economic Relations Commission.

The aim of these reforms is to improve the efficiency of the conduct of Soviet foreign trade and to improve the competitiveness of the Soviet Union in the world economy. This man who is the deputy director of the Foreign Economic Relations Commission, Ivan Ivanoff, in a recent meeting that I had with him stated the Soviet need to export more manufactured goods rather than relying on raw materials. The Soviets have been saying this for 20 years. Ivanoff's point, though, currently is that the Soviets can no longer rely on their exports of raw materials and that the need to become more competitive in the world economy now is much more pressing.

As I look at the prospects for expanded Soviet economic relations with the West and the prospects for competitiveness, I have mixed views.

First of all, reform, as I've said and others have reiterated, is a very long-term process and I would not expect anything dramatic to happen in terms of Soviet competitiveness in the world at least for the next 10 years into and past the decade of the 1990's.

Senator **Proxmire**. Mr. Levine, could you wind up in about a minute?

OUTLOOK FOR REFORM

Mr. **Levine**. Sure. The Soviets want to be a player in international economic relations and these are some of the issues that are being discussed.

Let me end with some comments on the prospects for success for reform taking hold. As I see it, the key element is bringing to the Soviet Union not only decentralization but domestic competitiveness. I think that domestic competitiveness is the key to all that they have been talking about in terms of modernization.

I think, by the way—and let me end with this—that foreign competitiveness within the Soviet economy is far, far in the future, that they are going to have to solve the problem of domestic competitiveness before they take on the troubles that foreign competitiveness will bring them.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Levine follows:]

PREPARED STATEMENT OF HERBERT S. LEVINE

GORBACHEV'S REFORM PROGRAM: ACT II

Prologue

The programs and discussions in the period from Gorbachev's assumption of power in March 1985 up to the Plenary Session of the Central Committee of the Soviet Communist Party at the end of June 1987 can well be viewed as Act I of the drama "Gorbachev's Reform Program." The curtain to Act II of the drama rises with the remarkable program put forth at the June '87 Plenum and the meeting of the Supreme Soviet that followed it.

Act 1

In Act I, early elements of Gorbachev's economic program were laid out. They consisted of three parts. The first was his policy on economic growth. Among his initial pronouncements on the economy, was his call for growth acceleration, a renewal of economic dynamism coupled with modernization and the improvement in quality of output. With regard to modernization of the economy, Gorbachev introduced a number of specific measures. In the period of the 12th FYP (1986-90) investment in the machine building sector is to be 80 percent higher than it was in the period of the 11th FYP. Emphasis is being placed on quality and advanced technology. New machines are to replace old machines. The rate of retirement of old machinery is to be doubled. In the machinery sector itself, it is to rise from an annual rate of four percent to a rate of 13 percent, with half of the stock of machinery and equipment being replaced during the 12th FYP period. Machine producers are to be penalized for producing obsolete equipment. Quality standards are being enforced by a new system of state quality control begun in January 1987. Strong attention is being given to the actual introduction of new technology into Soviet industry--a critical weakness in the Soviet economy. An indication of this attention, was the recent appointment as head of the State Committee for Science and Technology of a man from industry rather than from the Academy of

Sciences. Finally, a series of changes have been made in the direction of decentralizing the conduct of foreign trade and promoting joint ventures on Soviet soil with foreign firms, which have the aim of acquiring and assimilating advanced technology from the outside world.

A second component of the Gorbachev program was his "people program." It included the stress on discipline and the work ethic, the anti-alcohol campaign, and the massive change in the personnel of the country's political and economic leadership. In addition, under the policy of glasnost, there has been a historically unprecedented increase in the provision of information to the public. It would appear that the new Soviet leaders have come to accept the view that to run an effective modern economy and society, initiative and effort must come from below, people must have a sense of responsibility and must be held responsible for their actions; and for people to act responsibly, they must be given ample and accurate information about the economic and social situations with which they will have to deal.

The third component of the Gorbachev economic program as it developed in the March 1985 - June 1987 period concerned changes in the economic mechanism itself. This involved a wide array of issues, discussions, and proposals. The objective was to modernize the economy, to improve its level of efficiency and technology. The core elements were the increase in economic independence and flexibility of enterprises and the development of real incentives in the system that would lead workers and managers to work hard, efficiently, creatively, and honestly. To make it possible for enterprises to operate with greater independence and flexibility, it was recognized that substantial alterations in the structure of planning and administrative institutions would have to be undertaken, and the existing systems of supply, finance, credit, and price formation would have to undergo reform. For incentives to be effective, wage differentials would have to reflect productivity differentials; managerial bonuses would have to be tied to profit and quality and delivery obligations; private activity in the provision of consumer goods and services would have to be increased and a substantial rise in the inequality of income distribution would have to be accepted.

The intensity of the reform discussion, its frankness and boldness, builds through Act I of "Gorbachev's Economic Plans," with marked acceleration in late 1986 and early 1987. Noteworthy here is Gorbachev's speech at the January 1987 Central Committee Plenum, in which he was harshly critical of the Soviet economic system. The final scene of Act I, however, belongs to Nikolai Shmelev, an economist, previously not prominent in the reform discussions, whose article in the June 1987 issue of the literary and public affairs journal Novyi mir was a blockbuster of Soviet radicalism, both in the totality of its criticism of the Soviet economic system developed under Stalin, and in its proposals for reform.[1] It rocketed Shmelev, at least for the moment, to the pinnacle of the reform debate, and even elicited favorable comments from Gorbachev, who, though demurred from some of Shmelev's reform proposals.

Shmelev, in the article, argued bluntly and basically that the Soviet economic system put in place after NEP is fundamentally flawed. It represents, he said, a substitution of an administrative system of economic management for "the Leninist policy of economically accountable socialism."

> Our economy has been ruled for too long by decree instead of by the ruble. So long that we seem to have forgotten that there was a time when our economy was ruled by the ruble, and not by decree, that is by common sense, and not by arbitrary, theoretical speculation.
>
> I realize I am inviting reproach, but the question is too serious and vitally important to moderate my terms or resort to discreet silences. Unless we admit the fact that the rejection of Lenin's new economic policy (NEP) had the gravest complicating effect on socialist construction in the USSR, we will once again, as in 1953 and 1965, condemn ourselves to

> half-hearted measures. And half-hearted actions can, as is well-known, sometimes be worse than inaction. The NEP, with its economic incentives and levers, was replaced by the administrative system of management. This system, by its very nature, was unable to concern itself with improving output quality or increasing production efficiency, or with ensuring that the greatest results were achieved for the smallest expenditure. It sought to achieve the necessary quantity--gross output--not in accordance with objective economic laws, but in spite of them. And acting in spite of these laws means at the cost of inconceivably high expenditure of material and--most importantly--human resources.[2]

His proposals for reform ranged widely and amount to a call for undoing almost all that was put in place since 1928. Some of his key proposals concerned changes in Gosplan and the ministries, the system of price formation, the essential role of competition, and the positive function of unemployment in a socialist economy.

With regard to Gosplan, Shmelev charged that it has no time for what in a planned economy should be its major function--strategic planning. For it spends its time engaged in the everyday running of the economy: "Watching with the utmost vigilance to ensure that shoemakers stitch shoes and pastry cooks bake pies."[3] He stated that Gosplan should set physical targets for at most 250-300 types of strategic output and should distribute investment funds by sectors and republics, on this basis determining the most important national economic proportions.

He states that ministries are too numerous and their staffs so overblown that they have to find things to do, thus hampering the work of the enterprises. This situation requires a speedy radical solution. He quotes Lenin: "In our country everything is swamped in a foul bureaucratic morass of 'departments'. Great authority, intelligence, and strength are needed for the day-to-day struggle against this."[4]

The system of price formation, Shmelev writes, must be fundamentally changed. Prices should reflect market conditions and not be set by people in central offices.

> The voluntarist pricing decisions which have accumulated since the late twenties are a really terrible legacy. Unless we put an end to them we will never have objective cost guidelines for an undisputed comparison of the costs and results of production, not depending on human arbitrariness. And, therefore, we will never have true economic accountability. In today's theoretical debates various projects for transforming the price system are being put forward. However, the majority of these projects contain one common defect, a defect which, judging by our experience, is extremely dangerous: it is proposed that prices will once again be formed in armchairs, once again through theoretical speculation, divorced from life and from the real processes both in our economy and in the world economy.[5]

He went on to argue that subsidies on wholesale and retail prices must be removed, so that managers operating on profit incentives in markets for producers' goods, and workers' spending their incomes in markets for consumers' goods will make decisions that are economically rational.

For prices to be effective, for decisions by managers and consumers about what to buy to be meaningful, buyers must have choices, there must be competition in the market. The dominance of the producer over the customer must be broken. Moreover, competition is necessary to force producers to produce products of desirable quality and to pursue technical change.

> We should finally stop deceiving ourselves, stop believing the armchair ignoramuses, and calmly acknowledge that the problem of "choice for the (customer)," the problem of competition, has no social class undercurrents. This has nothing to do with ideology. It is a purely economic, even technically economic problem. Choice, competition--that is an objective condition without which no economic system can be viable or at least sufficiently efficient. Universal shortages, the diktat of the producer--that is not the kind of economic atmosphere in which producers will seek new technical solutions themselves, rather than under the whip. Any monopoly inevitably leads to stagnation, and absolute monopoly to absolute stagnation.[6]

The most controversial part of Shmelev's article, and the part from which Gorbachev publicly demurred, concerns Shmelev's ideas on the positive functions of unemployment in a socialist economy. He began by arguing that unemployment of a frictional type already exists in the Soviet economy, at 2-3 percent of the labor force. Second, in order for an economy to develop effectively, labor has to be moved from declining industries to new industries. Thus, where it is not needed, labor should be dismissed, and retrained and reallocated to where it is needed thereby increasing the level of frictional unemployment. Third, the controversial part, Shmelev argued that the threat of being fired from his job is necessary to get a worker to work hard. Economic coercion should be substituted for administrative coercion.

> Third, let us not close our eyes to the economic harm done by our parasitical confidence in guaranteed work. Today it is, I believe, clear to everyone that we owe disorderliness, drunkenness, and shoddy work largely to excessively full employment. We must discuss fearlessly and in businesslike terms what we could gain from a comparatively small reserve army of labor, an army not, of course, left by the state entirely to the mercy of fate. I am talking about replacing administrative coercion with purely economic coercion. A real danger of losing your job and going onto a temporary allowance or being obliged to work wherever you are sent is a very good cure for laziness, drunkenness, and irresponsibility. Many experts believe that it would be cheaper to pay an adequate allowance to people temporarily unemployed in this way for a few months than to keep in production a mass of idlers who fear nothing and who can (and do) wreck any economic accountability and any attempt to improve the quality and efficiency of social labor.[7]

Thus, by June 1987, the Soviet discussion of economic reform had come a long way from the beginning of Gorbachev's administration in March 1985. What was missing, however, was a comprehensive program to reform the economic system. The outlines of such a comprehensive program were provided at the June 1987 Party Plenum and meeting of the Supreme Soviet.

Act II

In Act I, the playwright identified the problems of the Soviet economy and described the approaches to a policy of reform that were developed during the first two years of the Gorbachev era. The Act I curtain came down on the crescendo of the January 1987 Plenum and the Shmelev Novyi mir article.

The curtain to Act II rises on the June 1987 Plenum. The outlines of the reform program are contained primarily in the two documents, "Basic Provisions for the Radical Restructuring of Economic Management," and the "Law on the State Enterprise," discussed and endorsed by the June Plenum and meeting of the Supreme Soviet.[8] The essential character of the program is a dramatic move toward economic decentralization which is to be in place for the beginning of the 13th Five Year Plan in 1991. The highlights consist of the virtual abolition of the annual plan and its obligatory targets, significant independence of enterprise behavior based on the pursuit of profit, flexibility in the allocation of labor, and reform of prices and the system of price formation.

Starting in 1991, Gosplan is no longer to construct an annual plan. Each enterprise will draft and confirm its own annual plan (and five year plan) based on control figures and long-term economic norms, and state orders (goszakazy) for products of critical importance to the economy and national defense.

Apparently there was strong debate about whether to have Gosplan construct and issue control figures as guidelines to enterprises in their construction of their plans. For, though the control figures are not to be obligatory for the enterprises, there is always the danger that they will become so. Furthermore, giving Gosplan the labor intensive task of constructing control figures limits the extent of possible reduction in the

Gosplan staff.

The role of the goszakazy is very interesting. V.S. Nemchinov, the highly respected dean of Soviet economists in the 1950s and early 1960s (and who is referred to in Gorbachev's speech at the June Plenum), wrote several articles in 1964 proposing the abolition of the annual plan and replacing it with a system wherein Gosplan would announce the government's desire to buy stated quantities of certain key products and enterprises would bid for these contracts, competing on the basis of cost, quality, delivery time, etc. In this way, the state would continue to retain central control over the output of key products, but would also stimulate competition leading to cost reduction and improved quality. The role of state orders in the Basic Provisions is similar to the Nemchinov scheme. In the beginning, they will be obligatory, because until price proportions become properly aligned, the production of some of these products may not be very profitable and thus may not elicit sufficient bids from producing enterprises to meet the needs of the economy.

The goszakazy provide a convenient bridge from the old system with an obligatory annual plan to the new system without an obligatory plan. Since, in the initial transition period, the state orders will be obligatory, there is more assurance that the products of greatest importance to the state will be produced in the quantities desired by the state. This will give some reassurance to those who fear that decentralization will lead to economic chaos. The danger, of course, is that the goszakazy will remain obligatory, thus defeating their intended purpose. An additional issue is the scope of the goszakazy: will they cover the 250-300 strategic products suggested by Shmelev, or will they cover a larger proportion of Soviet output.

Enterprises are to be independent and responsible for the results of their activity. Out of the revenue they earn, they are to pay wages and salaries and provide for capital investment (full cost-accounting and self-financing). Investment funds will be augmented by expanded access to bank credit. Financing through the state budget will as a rule be excluded, retained only for the largest investment projects. Thus, the main incentive of the enterprise is to be the pursuit of profit.

To enable enterprises to operate decentrally, and to eradicate the prevalent "dominance of the supplier," the existing system of centralized supply will be abolished. Enterprises will be able to purchase the material and equipment they require through their free choice of suppliers--either directly from producers or from wholesale outlets (which will operate on a cost-accounting basis).

Enterprises will have more freedom in setting the size of their own wage funds and labor force. They will be able to dismiss workers, both because of poor work and because the workers are no longer economically needed. And the enterprises will be freed from the need to find new jobs for the dismissed workers. This and the provision of any needed retraining will be the responsibility of the state.

Enterprises will also have the "right" to go bankrupt. Those that chronically lose money will be merged with more successful enterprises, or may be shut down, their workers and transferable assets being redistributed to where they are needed.

In light of the changes in the nature and role of the plan, and the independence of the enterprise, the size and functions of Gosplan and the ministries will change. Their staffs will be reduced and they are to focus their attention on long-term growth and investment strategy, technological progress, and interbranch coordination and cooperation, rather than on the day-to-day operation of the economy.

The linch-pin of the comprehensive program of fundamental restructuring of the economic mechanism is the reform of prices and the system of price formation. First of all, prices are to reflect the "socially necessary" expenditures on the production and sale of goods, their consumption characteristics and quality, and the effective demand for them. That is, they are to reflect supply and demand. Prices are to cover payments for capital stock, labor and natural resources, and expenditures on environmental protection. The proper relationships among different types of prices are to be put into effect. These include the relationship among wholesale prices, procurement prices, retail prices, and wage rates; and that between prices of raw material products and manufactured products. Subsidies are to be phased out and thus prices of raw material goods will rise relative to manufactured goods. This will involve the gradual increase in consumer prices. It was stated, however, that this will not be permitted to lead to a decrease in the standard of living of workers. What is intended is the use of cost-of-living wage supplements as has been done in some East European countries and China.

Secondly, the system of price formation will be significantly decentralized. A three-tier system will be used: centrally fixed prices, contract prices allowed to fluctuate within established limits, and freely-fluctuating contract prices. The share of centrally fixed prices is to be sharply reduced covering only the most essential producers' goods and consumers' goods. Contract prices are to be negotiated between sellers and buyers. The Basic Provisions include a statement on the necessity of substantially enhancing the role of users in the determination of prices, thus again emphasizing the need to alter the balance of market power in the Soviet economy between sellers and buyers if the reform program is to succeed.

Finally, the June Plenum formally laid out a timetable for the introduction of the various elements of the reform program. In general, the new system is to be in place for the beginning of the 13th Five Year Plan in

1991. The Plenum warned that it is impermissible for a lack of reliable organization, slowness, and absence of coordination, to lead, as in the past, to delays and incomplete implementation of the reform. Furthermore, the Plenum stated that all existing laws and regulations that conflict with the Basic Provisions and the Law on the State Enterprise will be revised and revoked, and that any enterprise activity not specifically prohibited by law be considered to be permissible. The latter clearly is aimed at preventing the ministries from doing what they did with the 1965 reform, namely issuing regulations for the enterprises that conflicted with the reform thus contributing to its failure.

This comprises a truly radical program of economic reform. When coupled with other--political and social--reforms that have been undertaken, it can be said that Gorbachev has launched the Soviet Union into an era of revolution from above. The aim of this program of revolutionary change is to modernize the Soviet polity, society, and economy, and make the Soviet Union, in the long-run, a more effective economic and military competitor.

One interesting consequence of this reform program is its effect on the issue of arms control and in particular the Soviet response to the U.S. S.D.I. program.[9] If Gorbachev's radical economic reform and modernization program is to have any chance of success, it will require continued, focused political attention and abundant economic resources in order to maintain its momentum. Gorbachev's reforms have unleashed economic and social forces within Soviet society that must be carefully managed from above. By staking his political position on the success of his ambitious program, Gorbachev has taken a great risk. It is therefore likely that he would be very reluctant to dilute the reform program and sidetrack attention from his priority of restructuring the economy. Any substantial Soviet response to SDI now would endanger the economic reform and modernization drive since it would deflect the required political attention and resources. To modernize Soviet industry, both human and material resources have to be moved from the military sector to the civilian sector. These include highly skilled managers, engineers, machinists, system analysts; and micro-processors, micro-electronic components, and high-quality speciality steel products. There is evidence that Soviet leaders realize this necessity and have been moving in this direction.

The promotion of arms control agreements and a minimal response, in the near-term, to current U.S. space defense efforts would allow the USSR to retain its focus on the Gorbachev program in the hope that after a decade of progress in economic reform and modernization the Soviet economy will be in a better position to support a program of more advanced countermeasures to the long-term threat posed by SDI. Indeed, the long-term threat provides an added impetus and justification for sustaining fundamental economic reform in the USSR since a more robust economy is required to improve the high technology base. A generally more efficient economy, more advanced industrial technology, in particular in computers and electronics, and better inter-industrial branch coordination, are necessary for the production and management of complex weapon systems.

In closing this brief discussion of the opening scene of Act II of "Gorbachev's Economic Plans," with its dramatic introduction of a program of radical economic reform, one further comment on the process of reform and its possible success. Soviet leaders are drawing on ideas that began to develop in the Soviet Union at the end of the 1950s, with the mathematical revolution in Soviet economics, the work of Nemchinov and Kantorovich, and the view that economics is a science of constrained maximization and the economy should be decentralized with enterprises pursuing profits in a competitive environment with prices accurately reflecting (marginal) costs and benefits. The current principal economic advisers to the Soviet leaders were then in their formative years, as were the current Soviet leaders.[10] Gorbachev, in his speech at the June Plenum, complains of the loss of twenty years, in his reference to Nemchinov's call for economic reform in the mid-1960s. But such a delay in the introduction of new ideas is to be expected.

The analogy to the famous last section of John Maynard Keynes' revolutionary General Theory is compelling. The words written by Keynes during the capitalist crisis of the 1930s are strikingly apt for the socialist "precrisis" (as Gorbachev put it) of the 1980s.

> Is the fulfillment of these ideas a visionary hope? Have they insufficient roots in the motives which govern the evolution of political society? Are the interests which they will thwart stronger and more obvious than those which they will serve?
>
> ...if the ideas are correct...it would be a mistake, I predict, to dispute their potency over a period of time...the ideas of economists and political philosophers, both when they are right and when they are wrong, are more powerful than is commonly understood. Indeed the world is ruled by little else. Practical men, who believe themselves to be quite exempt from any intellectual influences, are usually the slaves of some defunct economist... I am sure that the power of vested interests is vastly exaggerated compared with the gradual encroachment of ideas. Not, indeed, immediately, but after a certain interval; for in the field of economic and political philosophy there are not many who are influenced by new theories after they are twenty-five or thirty years of age, so that the ideas which civil servants and politicians and even agitators apply to current events are not likely to be the newest. But, soon or late, it is ideas, not vested interests which are dangerous for good or evil.[11]

Footnotes

1. N.P. Shmelev, "Avansy i dolgi," (Advances and Legacies), Novyi mir, 1987:6 (June), pp. 142-158. Translation in FBIS-SOV-87-117A(Annex), Daily Report: Soviet Union, 18 June 1987, pp. 1-20.

2. FBIS, op. cit., p.1.

3. ibid, p. 11.

4. ibid.

5. ibid, p. 12.

6. ibid, p. 15.

7. ibid, p. 9.

8. The following discussion is based on readings of the Soviet press and discussions with Soviet economists at the 12th SRI-IMEMO Conference, Menlo Park, California, July 6-8, 1987, and at the 3rd SSRC Workshop on Soviet and East European Economics, Georgetown University, July 13, 1987.

9. Parts of the next two paragraphs were developed in consulting work done by the author for National Security Research, Fairfax, VA.

10. Aganbegian, for example, moved to Novosibirsk and began working with Kantorovich in 1961 when he was in his mid-twenties. See P. Taubman, "Architect of Soviet Change," New York Times, July 19, 1987. p. D3.

11. J.M. Keynes, The General Theory of Employment Interest and Money, New York: Harcourt, Brace and Company, (1936), pp. 383-384.

Senator **Proxmire**. Thank you very much.

Mr. Luttwak, please proceed.

STATEMENT OF EDWARD LUTTWAK, SENIOR FELLOW, CENTER FOR STRATEGIC AND INTERNATIONAL STUDIES

STRATEGIC IMPLICATIONS OF REFORM

Mr. **Luttwak**. Thank you.

I am not a professional Sovietologist. I, therefore, have always viewed and tried to view the Soviet Union exclusively as a strategic phenomenon externally. I'm supposed to know something about strategy.

I would like to offer a very simple categorization of the strategic implications of the current reforms. Before I do that, I would just like to reiterate two cautions about the importance of this with regard to the defense side of this broader question—not the foreign policy, but strictly the military balance narrowly interpreted.

The first one is the one the chairman himself noted at the beginning; namely, that the Soviet Government controls Soviet resources in a way that many other governments don't control their economic resources. This has meant from the point of view of the military balance, of course, is that the Soviet Union has been able to achieve military balance with the United States that in no way corresponded to the GNP balance. And this has been so in the past and it will continue in the future.

POLITICAL CONTROL ASSURES MILITARY POWER

Even if the Soviet economy stagnated, the Soviet Union could still retain tolerable military balance for a long time to come, assuming that the political control over the GNP.

So what I'm saying is that from the narrowly viewed, purely from the point of view of the military balance, the reforms are not going to be important one way or another for some time.

SOVIET MILITARY POWER LESS DEPENDENT ON TECHNOLOGY

The second aspect is, of course, that the composition of Soviet military power as a whole has been much less dependent on technological advancement than in our case. True, there are some weapons in the Soviet inventory that must achieve a certain level of technicity. You can't substitute a great number of cars or trucks for a ballistic missile, but there is a lot of substitution possible and the Russian military tradition, even before the Soviet, has been one of successful substitution, not only of numbers but of good tactics, good operational methods to regularly defeat technically superior antagonists.

Hence, again, even if let us say Brezhnev had lived for another 35 years or so and the stagnation had continued, that would not have produced catastrophic effects on the military balance from the Soviet point of view.

Conversely, if the reforms are splendidly successful, they will not bring about catastrophic changes from our point of view.

Our tradition in the military area has been at least to believe that everything depended on high technical attainments of our weapons. In the Soviet and the Russia before, it has been to do very well with technically inferior equipment. This is clear.

EFFECTS OF REFORM ON SOVIET PRESTIGE

Now let me just go to the effects. I will be offering you to some extent the very simple characterization, nothing original, so I will make it very brief.

First, the anticipated effects of the Gorbachev reforms. The effects were felt before the reforms were even written out or declared, let alone implemented. The anticipated effects were, of course, purely political, did not affect the military balance. It affected the broader political context in which the military balance operates and what happens, of course, is having leaders in the Soviet Union talk reform repairs to some extent the catastrophic accumulated damage suffered by Soviet prestige because of the perceived state of Soviet stagnation.

The loss of prestige is felt politically. The friends of the Soviet Union, a diminishing band in Western Europe, were increasingly embarrassed by the connection. When people went to the Soviet Union for travel as tourists, they were not proud of it. They were kind of ashamed of it. So there was a dissociation process which affected obviously the role of the Communist party itself.

FRENCH REACTION

Now the Soviet Union, therefore, has made political gains merely by saying that he wants to do something. These gains have varied a great deal in their impact country to country, ranging from France where the general position has been a fundamentalist position that all the Gorbachev liberalization measures are revokable; they were not produced because of an organic political phenomenon; they were produced because Gorbachev said so, liberate Sakharov, do this, do that, and he can undo it. And the French, being realists, essentially allowed very little to the Soviet Union.

GERMAN REACTION

The other extreme would be the case of Germany, where the Germans, of course, for obvious reasons, have been wanting to believe desperately in these reforms, and we are very close to the German position really, compared to the French. The French treatment of the whole Gorbachev phenomenon is that basically it is of no consequence because it is all revokable.

EFFECTS ON THE ECONOMY

Now let me address the economic effects very simply beyond not the anticipated political effects but the economic effects, short, medium and long in prosaic terms—one-liners.

The short-term effect. Obviously after there are a lot of accumulated backlogs of easily achievable improvements—construction projects that were being built, misapplication of incentives—and we've had this discussed by more expert people than I. Onetime gains show up in the GNP. Some of them are available for additional military expenditure. That has some strategic implication but, of course, very feeble because of the two detractions I mentioned at the very start.

Medium-term effects—3, 5, or 7 years. Well, if economic restructuring is achieved harmoniously, the military sector should benefit pro rata as far as if its share of the gross GNP remains the same.

Professor Levine has identified a factor which may prevent the military sector from receiving a qualitative improvement as well. That is, if one of the inputs in the Soviet GNP growth is the transfer of quality resources from the military to the civilian sector, then there will not be that benefit obviously and there will be no impact on the balance of power.

Finally, the long-term effects. Now strategy is not concerned with welfare. Strategy is only concerned with relative performances that are relevant from a power point of view, not narrowly military, but also what countries have available to give away as economic aid and support.

Now since the concern is not welfare, there is no meaning to it all except comparatively, except relatively, compared to other countries, notably the United States.

WEAKNESS OF THE U.S. ECONOMY

Now, given the uncertainties in American long-term economic performance and the very serious factors which are already diminishing our true power in international affairs because of our economic performance, prediction is really impossible even in a room decorated with zodiac signs.

We have a situation today where the United States' external economic performance is such that the United States cannot use the instrument of economic aid as freely as it did in the past. This weakens the United States very substantially.

Now, it's hard to predict what will happen in the Soviet Union. It's impossible to predict what will happen in this interaction between a declining Soviet state that is making an attempt to revive its economic performance and a declining American economy in which attempts are so far sporadic and no benefit from being enforceable by the KGB, although if we did have police powers in this country we could use them probably to some effect to achieve some improvements.

POLITICAL EFFECTS OF GLASNOST'

Now the political effects of glasnost' as broadly interpreted. First of all, political effects are not tied to any time distinctions. You can't break down political effects into short, medium, and long because political effects are driven by powerful leads and lags—anticipation of things that haven't happened and very slow reaction to things that have happened.

STABILITY OF THE SOVIET UNION

Now the fundamental point which different people made in different ways is that the Soviet Union is not an organically stable state entity the way that, for example, Chile is or El Salvador. The Government of El Salvador is disputed, but the state of El Salvador is an originally stable state. No El Salvadorans particularly want to divide it into three parts or extend it or shrink it and so on.

The Soviet Union is more in the position of South Africa, where the entire boundary and definition of the state is in dispute. It is open.

Second, of course, the Soviet Government is a government which has not had as much legitimacy as some other governments.

Now the catastrophic projections one can make from this—say, glasnost' continues and you have a breakup of the Soviet Union. We have the pleasure of having a large number of new Islamic states arising in Central Asia. All of these things I don't think it's worthwhile talking about. We should bear in mind the projections. But I think we can anticipate some things if we limit ourselves to noncatastrophic outcomes.

One noncatastrophic projection is that insofar as glasnost' is necessary to release energies or stimulate the energies which are then required to accomplish economic restructuring, then that kind of great economic participation obtained by political stimulation has already made promises about increased salaries and so on for different professionals.

Senator **Proxmire**. Mr. Luttwak, could you wind up in about a minute?

EFFECTS OF GLASNOST'

Mr. **Luttwak**. Yes, 1 minute. So the strategic implications are, if you have glasnost' and no catastrophic outcomes, you have to give more money to people that is not available for either state controlled investment or for military expenditures.

Second, on the nationalities question, noncatastrophically, one way of keeping restive nationalities less restive is to pay them off. That, too, will have to come out of military expenditures and investment.

Finally, the Russians, too, are a nationality and if we think back to what happened to the last multinational empire that broke up, the Austrian-Hungarian, a very important factor wasn't just the Hungarians and the Croates and the Slovians. It was the Germans who were disgusted with having to deal with all these people. They said, "Get rid of them." That was an important factor as well.

The Russians are a nationality and appear to be becoming restive, too. Thank you.

ARMS CONTROL

Senator **Proxmire**. Thank you very much, Mr. Luttwak.

Professor Hough, Professor Levine said that there's good reason, in his judgment, why the Gorbachev reform might constitute good news for arms control and peace. He points out that Gorbachev had gambled his future and that of his country that the reforms he proposes will succeed and I realize that Mr. Levine means the success, if achieved at all, won't appear for many years—10, 15, 20, maybe a generation, maybe more than that—and that the success will perhaps be only partial.

But he argues that this means that you have to shift highly skilled managers, engineers, systems analysts, microprocessors and also microelectronic components and high-quality steel products and so forth from the military to the nonmilitary economic sector.

Of course, the only way to do that without the Soviet Union falling behind in its military force and strength is to do that with an arms agreement.

Do you agree that that will be one of the motivating, driving forces which will force or persuade Gorbachev to move in that direction?

Mr. **Hough**. Yes. I think there are a number of things that will move him in that direction. That's one of them.

The second is that since there's no danger of war in Europe and no interest in it, we're both wasting huge sums of money and he has no interest in keeping it at the present level.

NO DANGER OF WAR IN EUROPE

Senator **Proxmire**. That's a remarkable statement. You say there's no danger of war in Europe. Does Gorbachev feel that way, too, do you think?

Mr. **Hough**. They have a scenario in which there is a solidarity-like riot in East Germany and the West Germans intervene in which they think something might come out, but essentially the Soviet Union has no interest in the conquest of Europe now.

Their military threat to security comes over the North Pole and the military alignment of Europe doesn't affect that. So that becomes more irrelevant.

The threat to security of the regime comes from things like solidarity and it would be a disaster if they communized Europe and had a Communist regime in England that they tried to keep in power over the channel.

Senator **Proxmire**. That's the rational approach, but——

Mr. **Hough**. Finally, they need technology and if they put in lousy Communist economies, who's going to provide them with their technology?

Senator **Proxmire**. Well, that's the rational position, but doesn't Gorbachev confront an enormous problem in the opposition (a) of a bureaucracy, which is going to have to be moved out of many of the things they do, lose much of their responsibility, lose much of their power; and (b) the military which has been very, very powerful and therefore, on the basis of this kind of analysis, would seem to have to give up some of its strength if only by negotiation.

CHANGING VIEW ON UNEMPLOYMENT

Then you have that remarkable quote—I don't know if you had a chance to see Professor Levine's complete statement—he quotes Nikolai Shmelev, a Soviet economist, praised by Gorbachev, who wrote what Mr. Levine calls "a bombshell of an article" in which, among other things, he said, "The threat of being fired from his job is necessary to get workers to work hard."

Now one of the proud boasts of the Soviet Union is that they don't have unemployment and Shmelev is saying, "That's one of our problems. We should have unemployment. We would have a more efficient system if we had it."

That seems to me to be a pretty radical attack on some of the things that the Soviet people have been told for many years and that they're proud of and that they feel comfortable in having a job and not having to worry about being fired.

Doesn't Gorbachev have to take on that kind of a sentiment among the broad population, as well as the bureaucracy, as well as the military, and overcome it in order to achieve these aims he's looking at?

Mr. **Hough**. Well, there are obviously a lot of people with a lot of interests who are in one way or another going to be frightened by reform, but it seems to me that that list in and of itself illustrates the problem of the analysis.

If the workers are going to be unhappy because they are going to be disciplined, then the managers are going to be happy because they are going to have the right to discipline. And there are a series of pluses to go with the minuses.

MILITARY-INDUSTRIAL COMPLEX

I think it's wrong to talk about the power of the military in the Soviet Union. The military has been extremely weak in the Soviet Union it seems to me historically and now. We've seen a power of a military-industrial complex and I think that's right, but the power there was in the defense industry. It was in people like Rustinev and basically the defense industry let the military down. That is, the defense industry was better than the civilian industry, but it did not give the Soviets the same kind of high tech, let alone of course the air-conditioned tanks and the like, that is the creature comforts that the officers wanted.

I think the military—and this came up in Marshal Argokev's position—hated Rustinev and hated the defense industry and they are strong supporters of reform precisely because Gorbachev is going to give them the heads of the defense industry and the electronic industry that have not been doing a good job.

In general, in terms of the bureaucracy and the workers, I think a man like Brezhnev who was 15 years old during the civil war, they were like the revolutionary guard in Tehran in the 1970's, and these are frightened, insecure people. And it's a working class one generation, but that's past now.

INTERESTS OF THE MIDDLE CLASS

A middle class—obviously, who likes unemployment? But workers are the ones that want the rock and roll. They want to travel to Finland. They want good television. But first and foremost in development terms, what is happening in Russia is what is happening in Britain is what is happening in the United States—at early stages of industrial development, workers are more important and have power. But as societies go middle class—and this is a middle-class revolution. These are not bureaucrats. This is a middle class that wants more freedom.

I think I have in my statement something I say in my speech often, that for the Russian bureaucracy, the ancient drive for warm water ports has given way to a drive for warm water beaches on Capri and the Riviera. In comparison with the bureaucrats, the professionals, the administrators of London, of Washington, of Rome, this is an extremely repressed, an extremely underprivileged middle class that desperately wants what Gorbachev is giving them and is quite willing to accept the sting of competition to have a better life.

POWER OF GORBACHEV

Senator **Proxmire**. Mr. Levine, I want your response to that, but I would also like you to consider Mr. Hough's statement that Gorbachev seems to have a great deal more power than an American President. He has power with no Congress, no Supreme Court. He faces no checks and balances, no elections. It also is a totalitarian country in which the politburo controls the economy completely.

Then he points out that, in spite of all the mistakes and the buffoonery of Khrushchev, Khrushchev stayed in office for 11 years, although as Mr. Hough points out, he lost China, brought Russia to the brink of war twice, first in Berlin and then in the Cuba missile crisis. He offended every institutional interest in the Soviet Union and obviously didn't have the kind of public relations skill and so forth that Gorbachev has so well demonstrated.

Do you agree with the notice that Gorbachev is likely to stay in office for many years and is likely to succeed?

Mr. **Levine**. As an economist, I have always found it wise to try to stick to economics and economic analysis, as I think Professor Tomsao found out last week at the hands of Senator Specter. But you sorely tempt me, Mr. Chairman, to stray into the field of politics.

Since Jerry Hough and I go way back to graduate student days together where we discussed issues of politics and economics, let me take a shot at it.

We are in the process of tremendous change in the Soviet Union, just tremendous change. And one of the most difficult things for scholars to do is perceive change when it is occurring. We're specialists on analyzing the past and trying to understand the past and apply the past to the present and perhaps to the future.

The present period is one where, as I said in my prepared statement and as I repeated in my oral statement, in truth, Gorbachev is attempting a revolution. And whether one can successfully conduct a revolution with all the pain, some of which you have indicated, of decreasing stability, of moving that income distribution in a much wider way, the whole issue that all societies face of equity versus efficiency, these things and many others Gorbachev is attempting to change. In a sense, the whole relationship between state and people he's attempting to change.

The issue than, in terms of how long he will last and ultimately will he or will this reform movement ultimately succeed even after him, is a constituency issue.

Now it's often put, is Gorbachev Peter the Great? That is, is Gorbachev surrounded by a very small band of reformers who want to force reform on to the society or are things different? Professor Hough has alluded to a middle class. One of the things that's been happening in the last two decades is a tremendous change in Soviet sociology.

CONSTITUENCY FOR REFORM

One of the startling things that I was not monitoring and it startled me when I saw it, in 1980, there are in the Soviet Union 21 cities with a population of a million or more people. If you look in the United States in 1980, there are only six such cities.

Now we have very large greater metropolitan areas, but the issue that is brought to the forefront in this rate of urbanization is that the Soviet Union now faces a problem of administering 21 cities of a million or more population and they're doing a terrible job of it in terms of providing economic benefits, the services that are required, making things work for that population.

It seems to me that the constituency that Gorbachev is drawing on is much wider than many of us and many of the people looking at his problems say he faces. I have found in sort of watching Gorbachev—and we've been watching him for—Jerry Hough has been watching him probably for 20 years. He has become prominent to those of us who don't look that closely at Soviet politics for at least 10 years.

He is an amazingly successful man. He has moved ahead. People were talking in March and April and May that he was losing power, that he was becoming conservative. And then the June plenum at the end of June 1987 comes about and he's soaring again with a very radical program. He is a very capable guy and I would prefer not to bet against him, as awesome as his task is—not to bet against his surviving for many years. Whether he will be successful or not, I think is just impossible to predict.

Senator **Proxmire**. My time is up. Congressman Solarz.

OTHER COMMUNIST REFORMS

Representative **Solarz**. Thank you very much, Mr. Chairman.

Mr. Levine, are you in a position to compare the modernization and reform and restructuring program now underway in the Soviet Union to what has taken place in China, Hungary, and Yugoslavia?

Mr. **Levine**. Well, I can take some shots at it.

AGRICULTURAL REFORM

When you look at China, both China and Hungary have demonstrated that reform in the agricultural sector is doable, that breaking up these very large units, identifying smaller units, really family units, works, even if you keep it within a general form of a collective farm or some larger unit.

It has been a surprise to many of us that Gorbachev has not moved even more rapidly in this direction. Success in agricultural reform spreads very quickly and it would in the Soviet Union. The well-being of a people that comes from successful production of food is a tremendous benefit to a political leader who is embarked on a process of change.

In his speech—not in the documents yet, but in his speech at the June 1987 plenum, Gorbachev goes into lengths in pushing forward reform in agriculture. One might speculate that in the documents that were hammered out there was not enough support for agricultural reform of the type that he wants and that you find in Hungary and in China.

NONAGRICULTURAI REFORMS

In the nonagricultural sector, sticking to Hungary and China, putting Yugoslavia to the side for the moment, in the nonagricultural sector, the reforms in Hungary and China have not been that successful so far and all of the pessimism in Hungary—or much of the pessimism in Hungary these days about Hungarian reform pertains to the difficulties of decentralizing these socialist economies and getting all of that incentive, that internal competition.

Gorbachev is trying it. The things that he's trying are very similar—with a number of changes, but very similar—to what they have tried in China and Hungary.

Yugoslavia is just totally different. Yugoslavia is an economy built upon workers management. That is, in essence, a market economy.

ECONOMIC SAVINGS FROM START AGREEMENT

Representative **Solarz**. Let me ask any of you who care to comment for your judgment about the extent to which the Soviet Union might expect to be able to achieve major savings in arms control agreements. I have in mind particularly a START agreement which might provide for roughly a 50-percent reduction in strategic weapons and then also conventional arms reduction agreement, say for the purposes of discussion, which might be in the order of magnitude envisioned by the Budapest appeal.

Would agreements in either of those areas more or less along those lines produce substantial savings? If so, in what way and what order of magnitude?

Mr. **Levine**. Well, if I could start on that, as I've already said, if you look at the START agreements and INF, as you've already said, in terms of rubles' worth of savings, they don't look very impressive and, as I've argued, I don't think that's where one should be looking however.

In terms of what it means to Gorbachev—to our understanding of Gorbachev's relations with his military, for Gorbachev to be able to go forward in these directions would mean at least to me that enough of the military leadership has accepted the idea that long-term competitiveness is worth a gamble of maybe a decade of restrained military expenditure and it's the movement of those high-quality resources into the civilian economy to build that modernized base.

Conventional, though, has one added advantage of releasing men and those men can be used in the labor force, especially to the extent that they're skilled.

Representative **Solarz**. I forget if it was in the late 1950's or early 1960's, but around then, if I recall correctly, Khrushchev demobilized a million Soviet troops.

Mr. **Levine**. Early 1960's.

ECONOMIC SAVINGS FROM 1960'S DEMOBILIZATION OF TROOPS

Representative **Solarz**. Do you have any retrospective assessment of how much money was saved, if any, by the demobilization of those troops?

Mr. **Levine**. Well, I'm sure we do. I don't have them.

Mr. **Luttwak**. That was the time when the Soviet GNP was growing very rapidly. The analyses that were presented to this committee and bodies like it showed that this rapid Soviet growth that we were worried about at the time was brought about by great big raw inputs into the system. It wasn't that the system was getting more efficient. It was just getting people off the countryside and obviously the manpower is very important.

Could I comment on your questions more generally?

Representative **Solarz**. Certainly.

ECONOMIC SAVINGS FROM STRATEGIC WEAPONS CUTS

Mr. **Luttwak**. Strategic weapons cuts, what are they going to save for the United States? We save the operation and maintenance costs of Minutemen, ICBM's, and so on, but in fact we add more Tridents and so on.

I think that Professor Hough is completely right in saying that the Soviet military are weak and always have been. And I think if you cut strategic weapons 50 percent, the Soviet Union will continue to modernize. The savings will therefore be limited to the O&M costs. The O&M costs are very small because these things don't take that much.

Representative **Solarz**. Let me interrupt you on that point. If in fact a START agreement doesn't prevent modernization, which presumably it doesn't then to what extent, Mr. Levine, would the Soviet economy get the benefit of transferring the high-quality personnel out of defense industry into domestic industry because presumably they would have to keep them working on their modernization programs in the military sphere?

Mr. **Levine**. Well, it depends on what they do. That is, if they just transfer resources and high-quality resources within the military sector, then there is no benefit for the civilian. But it would seem to me that what Gorbachev is pressing the military leaders to accept is the transfer of some of those high-quality resources out of the military sector.

Mr. **Hough**. I'm not an economist and I don't have the numbers, but the analogy with the 1960's is dangerous in the sense that it was precisely at that time that in both the Soviet Union and the United States there was the first enormous buildup of strategic weapons. So in a sense, what occurred in the late 1950's and early 1960's was a decision to make strategic rockets and that was obviously expensive.

It seems to me in general there is a real danger in what we talk about arms control. Arms control in the United States has simply become synonymous with nuclear arms control and that simply doesn't save money. We talk about generational change in this country, but then everybody goes back to the ideas of John Kennedy who was the Brezhnev-Reagan generation and says, "We cut nuclear in order to increase conventional."

ASYMMETRICAL CONVENTIONAL ARMS CUTS

Representative **Solarz**. Well, if the one way to achieve really big savings through arms control is through conventional arms reduction agreements, let me ask you, given the existing imbalance between the Warsaw Pact and NATO, one has to assume that any substantial conventional arms reduction agreement that would be acceptable to the West would have to involve asymmetrical reductions in which the Soviets reduce their weaponry by substantially more than we do.

What incentive do the Soviets have to do that, given the advantages they already have by virtue of their conventional superiority in tanks, in mobile artillery, and the like?

Mr. **Levine**. But that simply is not useful to them. What good is that unless you're going to invade Afghanistan, which is a bog? I mean, a big Soviet military establishment is good if you want to keep NATO under American control. It's good if you want Voice of America to tell your people that you've solved the defense problem when you haven't. But military force that you're not going to use is worthless or next to worthless.

It seems to me on the question of asymmetry, we have a lot of decisions to make. They presumably are on the verge of reducing—if they start reducing their troops, they're going to reduce 500,000 on the Chinese border. Do we consider this part of asymmetry or not? How do we count Polish and Czech troops whose functions may be more to defend the country against the Soviet Union than to attack Western Europe?

EAST GERMANY

I would think that in general the place for an agreement that is solvable is in Eastern Germany, because if you ask what is the danger, the danger is not the Polish and the Czech troops or the troops on the Chinese border. It's this concentration of very high-quality divisions posed in an offensive configuration and that kind of problem it seems to me one should be able to negotiate.

FOREIGN POLICY

Representative **Solarz**. One final question if I might. You seem to argue, Mr. Hough, that the reform program in the Soviet Union is in fact likely to lead to a somewhat more benign foreign policy because if you have a more open society it somehow or other will lead to less aggressive inclinations. And we certainly hope that's the case.

But compare, say, the Soviet economy to the economy of Nazi Germany. My offhand impression is that there was much more openness in the Nazi economy, much less centralization, and the like. The most ambition Gorbachev seems to have in mind really wouldn't go nearly as far in taking the Soviet economy in the direction of more openness than what you had in Nazi Germany, and yet obviously Nazi Germany was a very aggressive state.

So I wish you could elaborate on this. It's obvious that if this reform and restructuring program works, they will have a more effective economy and thereby potentially be a more formidable challenger. But in what way do you envision this would be more likely to produce a more benign foreign policy that would be less of a potential threat to the United States and the West?

Mr. **Hough**. Well, benign—that's a difficult word. I'm with Hans Morganthau who said, "All states try to increase their power and the like," so I don't think even if the Soviet Union were democratized fully—I mean with Sakharov, I think we would have problems with Russia with Sakharov as president.

And I also would not necessarily say that an openness of economy leads to a difference in foreign policy. But it seems to me the question is why an economy is closed? If the economy is closed because you have a xenophobic leader, it seems to me that that's associated with a particular foreign policy.

DISMANTLING IRON CURTAINS

And I do think these two iron curtains are going to be dismantled together—that is, the iron curtain against Western ideas, and the iron curtain against Western market forces. It's not that it's becoming more open in and of itself is so crucial as that the mentality which now permits that, which says, "Yes, we need French restaurants and Italian restaurants and maybe even New York Times in Moscow, and Moscow should be a culture center"—if that mentality changes, then it has foreign policy implications.

FOREIGN INVESTMENT

In the direct sense, the place so far as Europe is concerned that leads them to reduce forces is that they want Volkswagen in Moscow. And why are the Germans and the Japanese going to have billions of dollars of foreign investment in the Soviet Union if they think the Soviet Union is about to attack?

So to some extent, if you're trying to seek not simply to buy foreign technology, but if you're seeking long-term foreign investment, then you're driven to reassure people in a way in which Brezhnev was not. And that would be the one place I might see some direct impact.

Representative **Solarz**. Thank you very much.

ARMS CONTROL

Senator **Proxmire**. Thank you, Congressman Solarz.

Mr. Hough, you seem to argue that the zero sum option was a mistake as far as U.S. interests are concerned because it gave the Soviets an excuse to withdraw SS-20's and short-term missiles. This will create the danger of decoupling of Europe and the United States because if Europe no longer feels threatened the military alliance might deteriorate. That is the NATO alliance.

Isn't it a logical extension of your argument that it would be in our interest not to have an arms agreement or for the Soviets to lessen the military threat because those actions will lead to decoupling?

Mr. **Hough**. Well, it seems to me the first thing that we have to be concerned with is our own interests. We do have problems. We have major economic problems. We have problems with rightwing extremism which is more the disease of middle level industrialization. And the question is, how do we solve those problems?

I would much prefer to go the path of reducing threatening Soviet forces that are very expensive to us, like the conventional, and be less concerned about the threats to us that are more symbolic.

Indeed, if you're talking about the SS-20, former Secretary of State Kissinger is right, that we get nothing directly out of this agreement, there is no Soviet missile that could hit the United States that is removed, while the Soviets have a reduction there. So I would have——

ASYMMETRICAL CONVENTIONAL REDUCTIONS

Senator **Proxmire**. Do you think it's realistic to expect that the Soviet Union would agree to an asymmetrical reduction so that we could be on an equal basis at a lower level? The incentives on their side, of course, is that, as has been pointed out very well and thoroughly by you three gentlemen today, they would tend to strengthen their economy; they would give more force to the Gorbachev economic reforms. But at the same time, they would also provide a somewhat weaker position—not as strong a military position for the Soviet Union.

Mr. **Hough**. You mean asymmetrical in conventional forces?

Senator **Proxmire**. Asymmetrical. What I mean is that the Soviet Union would reduce more than we would reduce because they have more artillery, more tanks, more planes, more helicopters. They're ahead of us in all of those. And far more in personnel.

Mr. **Hough**. Well, if you're talking in general terms, first, we are going to have a real problem in counting because I think they will reduce more than we are, whatever happens, but part of it will be in conjunction with reductions in China.

So if they reduce 500,000 in Europe and 500,000 in Asia and we reduce 500,000 in Europe, you can say that is asymmetrical. But on the other hand, part of that is a counterpart with Chinese reductions.

Senator **Proxmire**. Well, you have a Chinese problem but they don't have nearly the forces on their Eastern front that they have on their Western front, do they?

Mr. **Hough**. No, but——

Senator **Proxmire**. There are about three times the forces on the Western front.

Mr. **Hough**. But they are peculiarly unnecessary there because China is not going to attack at all.

IMPROVING SOVIET TECHNOLOGY

Senator **Proxmire**. Professor Levine, Professor Hough says in his statement that if Gorbachev is to raise Soviet technology near world levels he must attack protectionism of Soviet manufacturers and he must push an export strategy like Japan and South Korea. He must also assume massive foreign loans once he gets his industry reorganized.

Would you comment on that thesis and do you see any evidence that Gorbachev is moving in that direction?

Mr. **Levine**. Let me take it from the bottom. The evidence so far seems to be in the Gorbachev group a concern about importation of

Western technology. There have been in his speeches comments that we must build Soviet technology, not to depend as we were in recent years—referring to the Brezhnev years of the 1970's—becoming so dependent upon getting our best machines from abroad.

Technology transfer is a two-edged sword and one has to handle it very carefully. I think that the thrust of Gorbachev's reform program is domestic and I think that they have come to the realization of the enormity of the changes that are required, including that fact that you have to have competition in the domestic economy. And with that, a year and a half ago when they first started talking about bankruptcy, we were all rather surprised. Now it's almost commonplace.

This is the idea of competition and of change and of allowing these incentives to work to develop new technology.

SOVIETS VERY UNCOMPETITIVE

Senator **Proxmire**. Now you come down very, very hard on domestic competition within the Soviet Union. You seem to feel—in fact, you said that exports are years away.

Mr. **Levine**. That's how I feel and I feel that allowing Soviet firms to be competed with by foreign firms in the Soviet domestic market is something that's also a long way off.

DANGER OF WEST GERMANY ACQUIRING NUCLEAR ARMS

Senator **Proxmire**. Mr. Luttwak, Professor Hough argues that one of the risks of decoupling is that West Germany might want to acquire nuclear weapons—West Germany—and there would be less pressure from a weakened NATO against the Germans doing so.

How do you respond to that argument?

Mr. **Luttwak**. Well, I think that German advances was a very serious concern perhaps 10 years ago or 30 years ago. It's not any more. Let me just take note of the fact that Mr. Hough's strategic analyses offered in his prepared statement are all based on the presumption that force is useful if you're planning a war tomorrow. The notion that armed force is useful precisely when there is no war but to achieve desirable political goals is absent in his analyses.

I think the general reaction is there is not the concern that the Soviet Union might have on this. I think the concern would be rather to preserve a power position projected over Western Europe. If it wasn't for the Soviet threat to Western Europe, the Soviet Union would simply be inconsequential to us in Europe. Europeans are interested in what Gorbachev may achieve. Europeans are not interested in buying much or selling to the Soviet Union, no interest in going there. They couldn't care less what the Soviet fashions were or music. So they would have been simply ignored for all these years were it not for military power.

Senator **Proxmire**. Do you feel that if the West Germans do develop their own nuclear arsenal that this would be a very serious threat that we could trigger a nuclear war?

Mr. **Luttwak**. It depends on when it happened. If it happened 25 years ago, it would be very explosive. But I think that you really have to fantasize about West German politics to see the basis there for any support by any significant coalition in West Germany to acquire nuclear weapons. This is simply not in the cards. As opposed to the very urgent question of preserving the Soviet power position, and I think this may well be part of the compromise between Mr. Gorbachev and other elements in the Soviet power structure.

The Soviet Union will maintain a certain stance with regard to military balance. I believe the young German who flew into Red Square was the victim of misperceiving the nature of that political compromise

POTENTIAL FOR STRENGTHENED SOVIET THREAT

Senator **Proxmire**. Professor Hough, how do you respond to the argument that Gorbachev needs breathing space from foreign pressures to deal with his domestic problems, that once he reorganizes and strengthens the economy, we will be faced with an even greater military threat?

Mr. **Hough**. It seems to me the question is timeframe. As Gorbachev himself said about the reunification of Germany, "Well, who knows what it's going to be in 100 years?" It seems to me that if you talk about what the world is going to be in the year 2025 or something, who knows? Maybe we'll need Russia as an ally against a fascist India or Brazil. I mean, who knows what's going to be happening in 20 or 25 years.

But it seems to me that it is very unlikely that the Soviet Union is going to get any major military technological breakthrough in the next 5 or 10 years, partly because the resources are going to be diverted to the civilian preconditions of military and, second, because the technological side of reform I suspect they will do fairly well is not going to bring them to Japanese or European or American levels that quickly.

So I think the fears of the military challenge within the framework of the rest of the century, that that's not in the cards.

OUTLOOK FOR REFORM

It seems to me the crucial point to understand is not—we are focusing very much attention to can they change the Soviet Union into the United States in 5, 10, or 15 years, and I think the answer to that is very clear. They can't change it into Japan in 5, 10, or 15 years. The answer is no.

But the question is, are they going to seriously try—which I think the answer is a very clear yes—and the second is, what are the foreign policy implications of it? If they are driven to break the American technological blockade, whether it works or not, we're going to have to deal with the effort to break the American technological blockade whether the reform succeeds or not because that will come to the very beginning. So it's the foreign policy implications that I would emphasize.

MILITARY EXPENDITURES

Senator **Proxmire**. You seem to feel that from a rational standpoint the enormous resources put into the military by both the United States and especially in the Soviet Union seem to be an utter waste. They both sit there with 10,000 strategic warheads, a small fraction of 10,000 strategic warheads hitting either the United States or the Soviet Union would utterly destroy both sides. Both sides would lose. Therefore, war is irrational and it's not going to happen. Neither side needs the colossal military strength that they have, that it's a waste, particularly on the side of the Soviet Union because they put about 15 percent of their GNP into the military. Is that right?

Mr. Hough. Yes, and I think the Soviets are more foolish than us because we can afford luxuries that they can't afford as much. I'm obviously making an incremental argument.

SDI

Senator Proxmire. Are they concerned with an SDI that would destroy the credibility of their deterrent?

Mr. Hough. I think the Gorbachev SDI has been a symbol.

Senator Proxmire. You think Gorbachev what?

Mr. Hough. The Gorbachev SDI has been a symbol. That is, if you're trying to overcome military and conservative opposition, what a politician wants to say in the Soviet Union is that technological backwardness is dangerous for defense, is dangerous for power. In politics you need symbols and it's wonderful to be able to say in the Soviet press, to use something like SDI, which in a worst case analysis is a total danger, and to use that as a symbol for the broader Soviet technological weakness which some day in the future may be dangerous and, therefore, which has to be attacked today.

So I think for Gorbachev the SDI has been more symbolic than—we don't think it's going to work in 10, 15, or 20 years and I don't think he does either.

GATT AND IMF

Senator Proxmire. Mr. Levine, I'd like to get your reaction to testimony by the Defense Department before this committee.

Professor Hough and others have said that the United States has very limited capabilities to stop Soviet reintegration into the world economy.

The Defense Department testified that we should oppose Soviet into GATT, into the International Monetary Fund, and the World Bank.

Do you agree with Professor Hough, and what should our reaction be to the Soviet entry into the international institutions? Should we oppose it or welcome it?

Mr. **Levine**. This is a complicated issue of what the Soviets can benefit from those, but in a short answer to your question, I do not oppose it.

I think that bringing the Soviet Union into international economic organizations, on balance, would be a good thing for us and for the West. All sorts of complications and regulations and agreements would have to be worked out.

Let me add to that, in this recent conversation that I've had with this fellow, Ivan Ivanoff, his comment was that their main focus currently—and this was last May—their main focus currently was observer status at GATT and that they have put IMF somewhat on the back burner.

Senator **Proxmire**. Let me ask you, Mr. Luttwak, do you agree that we should not oppose the entry or we should support the entry of the Soviet Union into GATT, IMF, and the World Bank?

Mr. **Luttwak**. Well, from a political point of view, the concern is that the Soviet Union enters into these organizations, the Soviet Union participates in the organizations, and it does so under its own rules. They would simply not be willing to participate in any of these organizations on an equal basis, adhering to the rules that all other members have accepted.

The notable case would be the United Nations. The Soviet Union has been participating all these years and was simply not accepting U.N. rules, U.N. charters, U.N. declarations of human rights, and so forth, or even supplying economic statistics for U.N. publications.

So the question is, observer status—I think Professor Levine may want to comment on this, but I would differentiate between things like observer status in GATT, which is a rule-making body per se, rather than an ongoing organization—would be something that should be acceptable. Participation in operating entities would impart the same long-term results as we have seen in Soviet Union participation in the United Nations, which is not the internationalization of the Soviet Union, but to some degree the Sovietization of the United Nations because the rules that suit the Soviet Union at any one time suit a whole lot of other governments which may not share its Communist ideology but like some of the creature comforts that go with the Soviet method of government, which is they'll have to publish things, they'll have to apply rules they don't want to—the same rules satisfy a lot of other authoritarian oligopolies in general. That is a real concern.

SOVIET INTEREST IN THE WORLD ECONOMY

Senator **Proxmire**. Mr. Hough, would you comment on that?

Mr. **Hough**. Well, first, I would like to agree that there's obviously a difference between GATT and IMF. GATT is fairly trivial, but in IMF you have to work out a lot of complicated questions on voting rights.

But I think we have a problem with the Soviet Union, that we see a series of pieces and we haven't fit them together and much of—on the issues we're talking about things are changing almost daily. The statistics are rapidly increasing and I'm sure they will.

As I said in my statement, Soviet interest in the world economy changes radically if they participate. We have all said what a terrible worker resistance there is, how workers will fear unemployment, how they will fear bankruptcy, etc., etc.

Some people say, well, they can't even reform. I think they can overcome worker resistance, but that's a problem. But if they are going to integrate into the world economy, what they don't need is wild gyrations in the world economy. I mean, if there's a depression in the West and they are in the world economy, it will affect their workers. So the more they integrate into the world economy, the more they have the interest of balancing, of easing the business cycle precisely in order to minimize workers resistance to the reform at home.

So I think the process is how to let them into these organizations gradually in a way that as they get in they perceive these interests rather than simply adopting United Nations behavior where their interests are very different.

THREAT OF RIGHT-WING EXTREMISM

Senator **Proxmire**. Now I'd just like to ask one final question of Mr. Luttwak. How do you respond to what I think was a very interesting and dramatic point made by Professor Hough that not only is the Khomeini period in Russian history over but the threat we face now is right-wing extremism such as from religious fundamentalism rather than left-wing extremism?

Mr. **Luttwak**. I'm sorry. Is this religious reference in the Soviet Union or worldwide, Khomeini?

Mr. **Hough**. It's an argument that generally left-wing extremism is a disease of the early stage of transition, but as the Germanys, the Spains, the Irans, and the like show, the right-wing extremism is more the problem of middle levels of industrialization. And Iran is a current example.

EXTREMISTS DON'T THREATEN

Mr. **Luttwak**. In the realm of strategy, extremism always has a double significance. On the one hand, the extremists cause the problems because they are extremists. On the other, they do not constitute such grave problems because the extremist political conduct is not associated with the effective management of economies and systems. So that the real extremists are a constant noise but they don't really threaten you because they can't generate the capabilities inside.

MILITARY POWER THREATENS

In this sense, in Gorbachev's Soviet Union I think that one must maintain all legitimate hopes of a more benign Soviet Union and there are different ways that could come about. But in the meantime, this is not the problem that confronts us. What confronts us is precisely that Soviet military power that Mr. Hough regards as unimportant because he sees military power as something that only matters if you fight a war tomorrow morning.

That has not been the problem for the last 40 years. The problem for the last 40 years, which among all these things has driven us to accumulate all those nuclear weapons that now seem unnecessary?

Our problem has been to balance the Soviet conventional strength which was pressing on us and on our allies. And that problem will not be altered one way or the other, I would argue, for a long time by whatever happens to the Gorbachev reforms. Should they be very successful, even if very long term, after the 1990's certainly, in the year 2000, it will alter the balance, assuming we proceed on the present course. But if we proceed on the present economic course, absolutely we will not have the problem because we will no longer be able to afford to play the role of a superpower. It is impossible, if we maintain a steady course and become a creditor, a deeply indebted, impoverished United States largely managed by foreign managers and owned by foreign governments, and still defend Europe and East Asia.

Senator **PROXMIRE**. Would you like to respond?

EXTREMIST LEADERS THREATEN

Mr. **HOUGH**. Well, on the question of extremists, I had in mind people like Hitler and Stalin and Khomeini and it does seem to me that obviously—and obviously Ed Hough would agree—when people like that gain control of huge military might it's more dangerous than when more moderate men are in control.

Senator **PROXMIRE**. How about the fundamental point made by Mr. Luttwak about military power? He's challenging your position.

Mr. **HOUGH**. I was making an incremental argument. I personally think that it doesn't matter if we cut the nuclear weapons in half or we double the nuclear weapons. I don't think it significantly changes the military balance.

Mr. **LUTTWAK**. I was talking about conventional weapons.

BOTH SIDES OVERBUILT

Mr. **HOUGH**. It seems to me that in general we are both overbuilt in terms of what the current danger or what our current interests are.

The point that I made about conventional weapons I would make the strongest and that I think that we have not assimilated is that there is this profound contradiction between our argument on the one hand that military power Finlandizes, that it carries with it political influence, and our understanding on an international relations theory that a threat produces a countervailing alliance.

EFFECTS ON NATO

It seems to me that what the effect is of this big Soviet military buildup has been to get their attention, but it's been to get the Europeans' attention—the effect has been to strengthen NATO, to make NATO an alliance that worked for 40 years as international relations theory suggests that it should.

My own feeling is that that was also the intention of people like Gromyko and Brezhnev. That is, Gromyko lasted for 28 years even though he was being clumsy at breaking up NATO precisely because Brezhnev and those wanted NATO to keep Germany under control. So in that sense, the military force had an influence.

But what seems wrong to me is the notion that suggests the theory against the evidence, that if you have a big force that powerful nations like Europe will become more receptive rather than more resistant. So I think they have to reduce the military force precisely in order to Finlandize Europe and get Europe to give them the amount of money that they want. So I see that contradictory relationship between military power and influence in Europe.

Senator **Proxmire**. Gentlemen, thank you very, very much. I think this has been an excellent panel, one of the very best we've had and one of the best I've had in the 30 years I've been in the Senate.

The subcommittee will stand adjourned.

[Whereupon, at 12:25 p.m., the subcommittee adjourned, subject to the call of the Chair.]

[The following information was subsequently supplied for the record:]

United States Department of State

Washington, D.C. 20520

1988 FEB 9 [illegible] 1:55
FEB 8 1988

Dear Senator Proxmire:

Thank you for your letter of October 6, 1987, transmitting five follow-up questions to my October 5 testimony on the implications of Soviet economic reform before the Subcommittee on National Security Economics.

My initial response of November 2, 1987, apparently and very regrettably failed to reach the Subcommittee.

Please find attached the answers to your questions, as well as the answers to two questions raised by Congressman Solarz during my testimony.

If I can be of further assistance to you on this or any other matter, please do not hesitate to let me know.

Sincerely,

Thomas W. Simons, Jr.
Deputy Assistant Secretary for
European and Canadian Affairs

The Honorable
William Proxmire,
Chairman, Subcommittee on National Security Economics,
Joint Economic Committee,
United States Senate.

QUESTIONS FROM SENATOR PROXMIRE

1. Joint ventures and technology transfer control.

Increased access to Western technology is certainly a motive for current Soviet interest in Western investment. Soviet success in encouraging greater Western investment in the USSR via joint ventures could indeed complicate Western efforts to control technology transfer to the USSR. By their nature, joint venture transactions are less specifically defined and more intimate than simple import/export transactions. Once a joint venture is underway, the incentive and mechanisms for effective technology transfer and assimilation are greater. However, the potential threat of Soviet joint ventures to effective technology transfer control should be kept in perspective, and will obviously vary from case to case, depending on the subject matter of the joint venture.

-- U.S. and COCOM restrictions on sensitive technology transfer will apply to joint ventures just as they have applied to discrete trade transactions. Western firms involved in joint ventures are not likely to invest their resources in joint ventures where technology transfer restrictions could eliminate the possibility of returns on such investments.

-- The intimacy of joint venture transactions is a two-way street, opening up Soviet end-use of Western technology to greater outside scrutiny and control than in the case of arms-length trade transactions, and thereby offering greater opportunity to learn of any Soviet efforts to use joint ventures for the acquisition of sensitive technology.

-- U.S. and COCOM restrictions on technology transfer to the USSR are based on national security concerns: we do not want the USSR to acquire from Western firms the kind of technology and equipment that would be used to improve Soviet military systems. Our restrictions on technology transfer to the USSR are not, on the other hand, a form of economic warfare aimed at denying any kind of technology to the Soviets. Indeed, technology transfer which demonstrates the economic advantages of mutually beneficial, peaceful non-strategic trade between the USSR and the West, and of free-market economics, is in the Western interest to the extent that it increases Western exports and provides incentives for the USSR to move towards more market-oriented practices and constructive dealings with Western trading partners.

-- To create attractive conditions for Western investment, the Soviet Union will be pressed to reduce traditional barriers against the outside world, and to reduce central political control over its economic decision-makers. These are both positive steps from the U.S. perspective.

2. Defining strategic trade.

Strategic trade is defined in the 1984 Export Administration Act as "the export of goods and technology which would make a significant contribution to the military potential of any other country or combination of countries which would prove detrimental to the national security of the United States." The specific contours of strategic trade are defined exhaustively by the Commodity Control List (issued by the Department of Commerce) of items which on national security grounds require licence for export to the USSR and other controlled countries, and the record of denials of such licences.

The elaboration and implementation of national security export controls is a process which appropriately solicits and reflects the perspective and expertise of several U.S. government agencies. I would not want to dispel the idea that different agencies of the U.S. government can at times approach the working definition of strategic trade from different perspectives, and hold different views on specific cases. This is both normal and useful. Bismarck once made an analogy between the legislative process and sausage-making: not always pretty to watch, but good end results. The same goes for regulating exports on national security grounds.

3. Expanded contacts between the U.S. and Soviet peoples.

As the fourth critical issue area of our policy agenda vis-a-vis the Soviet Union, the concept of expanded contact between our two peoples covers both trade and a variety of other kinds of exchanges.

It is U.S. policy to expand peaceful, non-strategic trade with the Soviet Union, with the proviso that our economic relationship with the Soviet Union cannot be insulated from other elements of US-Soviet relations, including the issue of human rights, and that all four issue areas in the relationship -- arms reductions, resolution of regional issues, human rights, and bilateral relations including trade -- are important.

It is also U.S. policy to expand cultural, educational, scientific, and plain people-to-people exchanges between the U.S. and the USSR. The objectives of such exchanges are to break down barriers and lessen distrust, to promote openness and honest communications, to communicate American views and values to influential segments of Soviet society, to create opportunities for the two peoples to get to know each other directly, and to illustrate to the USSR the benefits of maintaining peaceful relations with the international community.

4. Is it time that we enter into discussions with the Soviets about comprehensive conventional arms reductions?

The NATO Foreign Ministers' communique issued last June in Reykjavik made it clear that improved conventional stability in Europe is a priority task. We are negotiating with Warsaw Pact representatives in Vienna on a mandate for new conventional stability talks which we hope will begin early next year.

With increased prospects for an INF treaty which would result in nuclear reductions in Europe, the question of Eastern conventional superiority has again risen to the fore. The thirty Soviet ground force divisions deployed in Eastern Europe (and many more in the western military districts of the Soviet Union) represent the main threat to stability in Europe.

Recognizing that the MBFR talks are deadlocked despite NATO's December 1985 compromise proposal, both NATO and the Warsaw Pact have publicly supported new conventional arms control negotiations. In order to redress Eastern conventional superiority, we are pressing for negotiations aimed at a verifiable agreement on a stable balance of conventional forces at lower levels. The Western approach focuses on the need to eliminate destabilizing disparities and the Warsaw Pact's capability for surprise attack and sustained offensive operations.

5. Soviet membership in GATT, the IMF, and the World Bank.

Soviet interest in the GATT is part of a larger effort to obtain an international economic role commensurate with political/military superpower status, to legitimate the Soviet economy and to give Moscow a say in development of the international economic system into the next century.

The Soviets' stated objectives of participation are to improve "trade policy conditions" for international trade, to expand Soviet trade with GATT members, and to acquire experience for eventual full membership in the GATT.

The Soviets believe GATT involvement will help facilitate their efforts to expand exports and provide greater access to Western high technology and capital - important for Gorbachev's domestic reform efforts.

In August 1986 the Soviets sought to participate in the Punte del Este round of multilateral trade negotiations. The reaction of most GATT members was essentially negative and the bid failed. Nevertheless, the Soviets continue to pursue a GATT role as a long-term objective.

The US position on Soviet participation in GATT fora is clear: the Soviet economic and trade systems, based on central planning and non-market considerations, are incompatible with the underlying free market-oriented philosophy of the GATT.

Without substantial changes in the Soviet economic and trade systems, Soviet participation offers little to GATT members. The Soviets could not fulfill GATT's membership commitments.

Some of the changes Gorbachev is pursuing suggest Soviet practices eventually might move in the direction of greater compatibility with GATT norms, but drawing more definitive conclusions at this time is premature. We should await the outcome of these changes.

We also share the concern of other GATT members that Soviet participation could lead to politicization of an economic forum that functions well, thereby undermining its efficacy.

Finally, President Reagan has stated that Soviet participation in the free world economy should be conditioned on real respect and support for the values of freedom, agreement to reduce nuclear and conventional weapons, tangible improvements in their respect for human rights, and an end to their aggression in Afghanistan.

As for the IMF and World Bank, it is only in vague terms and at a low level that the Soviets have signaled interest in membership in these organizations. Hypothetically, a Soviet decision to pursue membership would raise questions similar to those posed by Soviet interest in participating in the GATT:

-- The centrally-planned non-market Soviet economic, trade and monetary systems are incompatible with the underlying market-oriented philosophy of these organizations.

-- Without substantial changes in the Soviet system, including price and currency convertibility policies, we do not see what Soviet participation could offer these organizations nor how the Soviets could fulfill membership commitments, including informational disclosures.

-- The same potential for politization would apply as in the case of GATT membership.